

CHOICES ABOUT ATTORNEY FEE-SHIFTING LAWS: FURTHER SUBSTANCE/PROCEDURE PROBLEMS UNDER *ERIE* AND ELSEWHERE†

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Increasing numbers of statutes and court rules either permit or mandate the shifting of attorney's fees during civil litigation. The erosions on the American Rule that each litigant should pay his own fees are often founded on differing rationales suggesting that the laws may be characterized as either substantive or procedural. In this Article, Professor Parness asserts that characterization is important in three settings: a case involving the Erie doctrine, a case involving a state court's choice between the conflicting laws of at least two states, and a situation involving separation of powers concerns over whether the legislature or the judiciary has lawmaking responsibility.

*Professor Parness argues that the failure to differentiate between substantive and procedural fee-shifting laws, especially in the Erie setting, springs in large part from a misunderstanding of Supreme Court precedents, particularly the dicta in footnote 31 in *Alyeska Pipeline Service Co. v. Wilderness Society*. He concludes that properly read, the rulings suggest that fee-shifting laws related to conduct triggering a cause of action are usually substantive, while fee-shifting laws related to conduct during litigation are typically procedural. Fee-shifting laws related to conduct surrounding the commencement of a lawsuit may be either substantive or procedural depending on their purpose.*

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INTRODUCTION

A long standing legal principle in the United States is win or lose, a litigant should pay his own attorney's fees. This principle, relatively unique among industrialized democracies, is known as the "American Rule."¹ An increasing number of statutes² and court rules³ that either permit or mandate fee-shifting in particular instances have substantially eroded this rule. Courts and legislatures have identified at least three rationales for the growing number of exceptions to the American Rule. First, fee-shifting laws help to deter misconduct during civil litigation. Second, fee-shifting laws encourage meritorious civil actions that might not otherwise be commenced. Third, fee-shifting laws promote the settlement of civil disputes without litigation.⁴ Given these differing rationales, a court may characterize a fee-shifting provision as either procedural or substantive.⁵ This distinction between procedural and substantive laws is especially important

1. Roe, *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 DUKE L.J. 651, 651.

2. A recent survey revealed 1,974 attorney fee-shifting statutes in the codes of the 50 states and the District of Columbia. Note, *State Attorney Fee Shifting Statutes: Are We Quietly Repealing the American Rule?*, 47 LAW & CONTEMP. PROBS. 321, 323 (1984).

3. With court rules, there has been an explosion in fee-shifting opportunities based on frivolous litigation papers which was triggered by the 1983 amendments to FED. R. CIV. P. 11. See, e.g., 10TH CIR. R. 3.1; ARIZ. R. CIV. P. 11(a); KY. R. CIV. P. 11; MICH. CT. R. 2.114(D), 2.114(E); MINN. R. CIV. P. 11; MO. R. CIV. P. 55.03; MONT. R. CIV. P. 11; N.C. R. CIV. P. 11; UTAH R. APP. P. 40.

4. Leubsdorf, *Toward History of the American Rule on Attorney Fee Recovery*, 47 LAW & CONTEMP. PROBS. 9 (1984).

5. Note, *supra* note 2, at 329. The commentator classifies state attorney fee-shifting statutes into two general groups: (1) procedural or general litigation statutes, and (2) nonprocedural statutes. Since the primary purpose of general litigation statutes is to discourage abuse of the judicial process rather than to protect certain parties, beneficiaries of these procedural fee-shifting statutes tend to be identified as "aggrieved party, prevailing moving party, or prevailing party." *Id.* at 331-32. Nonprocedural statutes, on the other hand, seek to protect certain parties and therefore tend to identify the beneficiary as "prevailing plaintiff, prevailing defendant, or prevailing specific party." *Id.* at 332. In addition to the different objectives, the commentator notes another difference between procedural and nonprocedural fee-shifting statutes:

[O]nly 29% of state attorney fee [statutes] have any standard to follow. Nevertheless, with respect to those statutes with standards, two items merit note. First, bad faith and substantial justification standards are confined mostly to general litigation statutes. In contrast, condition precedent and knowing or willful standards are the most common standards for nonprocedural attorney fee shifting statutes.

Id. at 333. See Comment, *Distribution of Legal Expense Among Litigants*, 49 YALE L.J. 698 (1939-1940). The commentator recognizes the procedural nature of fee-shifting provisions designed to discourage frivolous or bad faith suits:

when one of three questions arises. One question is whether, under the doctrine of separation of powers, a fee-shifting statute or rule is valid. The answer usually lies in the division of responsibilities for lawmaking between courts and legislatures. Another question is whether, in choosing among conflicting state laws, a state court should defer to the fee-shifting provision of another state. The answer implicates the dimensions of full faith and credit. The final question is whether a federal court sitting as a state court should give effect to a state fee-shifting law. The answer requires a recognition of the division of responsibilities between federal and state governments. While this Article chiefly focuses on the last question, its analysis has significance for the others.

Following the decision in *Erie Railroad v. Tompkins*,⁶ federal courts entertaining state law claims generally apply state substantive law and federal procedural law. This result promotes uniformity in the definition of state substantive law, while promoting uniformity in the procedural means by which federal courts enforce all claims. Although not all fee-shifting laws fall within the definition of state substantive law, a number of lower federal courts hearing state law claims have applied state fee-shifting laws without undertaking any substance/procedure analysis.⁷ This failure to recognize the distinction between substantive and procedural fee-shifting provisions has resulted in two troubling and related consequences: (1) federal courts have occasionally applied state procedural laws which the states never intended federal courts to apply, or which should not govern in a federal court because of the state's relatively small interest in the conduct of federal litigation; and (2) federal courts have failed to give effect to significant federal procedural law interests in fee-shifting.

Many of these lower federal court decisions have resulted from some unfortunate language employed by the United States Supreme Court when it addressed the issue of federal court deference to state fee-shifting laws. In *Alyeska Pipeline Service Co. v. Wilderness Soci-*

The theory that one bringing a frivolous action or an action in bad faith should be punished has its roots far back in legal history. The Athenian who unjustly accused a citizen of an offence against the state was fined if he failed to secure the votes of one-fifth of all the judges. Many procedural penalties were likewise recognized in civil cases by the Roman jurists.

Id. at 704 (footnote omitted).

6. 304 U.S. 64 (1938).

7. See *infra* notes 111-20 and accompanying text.

ety,⁸ the Supreme Court observed in footnote 31 that federal courts, in diversity cases, usually should apply a state fee-shifting law when it reflects a substantial policy of the state.⁹ Lower federal courts sitting in diversity have often interpreted footnote 31 to require them to apply all state fee-shifting laws.¹⁰ However, a closer examination of the substance/procedure dichotomy in fee-shifting laws,¹¹ early Supreme Court decisions on the use of state fee-shifting policies in federal court lawsuits,¹² and the Supreme Court's use of authority in footnote 31¹³ reveals that this interpretation is incorrect. Upon review it is apparent that the Supreme Court's language in footnote 31 is consistent with *Erie* and commands that federal courts hearing state law claims only apply state substantive fee-shifting laws. This language also suggests that state courts entertaining the substantive law claims of other states need only apply the substantive fee-shifting laws of those other states, and that many state courts possessing rulemaking powers may only promulgate procedural fee-shifting provisions.

In Part I, this Article will demonstrate that attorney fee-shifting laws may be characterized as either substantive or procedural in at least three settings, including cases governed by the decision in *Erie*. In Part II, this Article will examine lower federal court decisions that have applied footnote 31 and will demonstrate that these courts have not recognized the different characterizations of fee-shifting laws. Finally, in Part III, the Article will conclude by urging federal courts and others to be more sensitive to the substance/procedure dichotomy when they make choices about attorney fee-shifting laws.

I. THE SUBSTANCE/PROCEDURE DICHOTOMY IN FEE-SHIFTING LAWS

Some attorney fee-shifting laws are substantive and others are procedural.¹⁴ The differences are important when federal courts must choose between federal and state laws in a diversity setting, when state courts must choose between their own laws and foreign laws in

8. 421 U.S. 240 (1975).

9. *Id.* at 259 n.31. For full quotation of footnote 31 in *Alyeska*, see *infra* text accompanying notes 108-10.

10. See *infra* notes 111-28.

11. See *infra* Part I.

12. See *infra* Part II.A.

13. See *infra* Part II.B.

14. See *supra* note 5.

Full Faith and Credit¹⁵ and Supremacy Clause¹⁶ settings, and when legislatures and courts must choose the appropriate lawmakers in a separation of powers setting. Courts and legislatures should typically base the distinctions between substantive and procedural fee-shifting laws on whether the fee-shifting laws are intimately tied to claims or causes of action permitted under substantive laws or whether they are tied to the judicial processes available for resolving disputes about claims or causes of action. The Supreme Court recognized the distinction in *Marek v. Chesny*,¹⁷ a case involving the relationship between one Federal Rule of Civil Procedure (Federal Rule or rule), rule 68,¹⁸ and the Civil Rights Attorney's Fees Awards Act of 1976¹⁹ (section 1988).

Rule 68 provides that if a complaining party rejects a settlement offer, and the judgment finally obtained is no greater than the amount offered, the complaining party must pay the costs incurred after the offer was made. The term "costs" is not defined in the rule. The purpose of this procedural rule is "to encourage settlement and avoid litigation."²⁰

Section 1988 provides that a prevailing party in an action brought pursuant to section 1983²¹ or certain other civil rights laws

15. U.S. CONST. art. IV, § 1.

16. *Id.* art. VI, cl. 2.

17. 473 U.S. 1 (1985).

18. FED. R. CIV. P. 68 states:

At any time more than 10 days before the trial begins, a party defending against a claim may serve upon the adverse party an offer to allow judgment to be taken against him for the money or property or to the effect specified in his offer, with costs then accrued. If within 10 days after the service of the offer the adverse party serves written notice that the offer is accepted, either party may then file the offer and notice of acceptance together with proof of service thereof and thereupon the clerk shall enter judgment. An offer not accepted shall be deemed withdrawn and evidence thereof is not admissible except in a proceeding to determine costs. If the judgment finally obtained by the offeree is not more favorable than the offer, the offeree must pay the costs incurred after the making of the offer. The fact that an offer is made but not accepted does not preclude a subsequent offer. When the liability of one party to another has been determined by verdict or order of judgment, but the amount or extent of the liability remains to be determined by further proceedings, the party adjudged liable may make an offer of judgment, which shall have the same effect as an offer made before trial if it is served within a reasonable time not less than 10 days prior to the commencement of hearings to determine the amount or extent of liability.

19. 42 U.S.C. § 1988 (1982) provides, in part, that in any action to enforce § 1983, the court may allow the prevailing party reasonable attorney's fees as part of the costs.

20. *Marek*, 473 U.S. at 5, 10. Incidentally, there is no corresponding responsibility for a defending party who is found liable for more than the amount in a pretrial offer by the complainant.

21. 42 U.S.C. § 1983 (1982) provides, in part: "Every person who, under color of any statute

has the right to seek attorney's fees as part of the costs. One legislative goal of section 1988 is to encourage plaintiffs to bring meritorious civil rights suits so that the relevant civil rights laws may be more fully enforced. Another goal is to deter plaintiffs from bringing frivolous civil rights actions.²²

In *Marek*, plaintiff brought a section 1983 suit in federal district court. Defendants made a pretrial settlement offer of \$100,000, which plaintiff rejected. At trial the jury awarded plaintiff \$60,000. Pursuant to section 1988, plaintiff requested attorney's fees. Defendants argued that, under rule 68, plaintiff was not entitled to certain fees since plaintiff's attorney's fees for trial were a part of the rule 68 costs that plaintiff was required to pay.²³

In a majority opinion authored by Chief Justice Burger, the Supreme Court noted that the drafters of rule 68 were aware of the federal statutes allowing for attorney's fees as part of costs in particular cases,²⁴ and that the drafters did not define the term costs as used in rule 68.²⁵ The Court declared, "[A]bsent Congressional expressions to the contrary, where the underlying statute defines 'costs' to include attorney's fees . . . such fees are to be included as costs for purposes of Rule 68."²⁶ In denying plaintiff post-offer costs, including the ability to recover attorney's fees incurred after the settlement offer, the Court remarked, "Section 1988 encourages plaintiffs to bring meritorious civil rights suits; Rule 68 simply encourages settlements. There is nothing incompatible in these two objectives."²⁷ The Court thus determined that substantive and procedural fee-shifting laws could coexist. Unlike the appellate court,²⁸ the Supreme Court found that including attorney's fees as nonrecoverable costs under rule 68 did not alter a substantive policy in contravention of the Rules En-

. . . of any State . . . subjects . . . any citizen of the United States . . . to the deprivation of any rights . . . secured by the Constitution and laws, shall be liable to the party injured . . ."

22. *Marek*, 473 U.S. at 10; S. REP. NO. 1011, 94th Cong., 2d Sess., reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 5908. While encouragement of this kind is intimately tied with the enforcement of the civil rights law sued upon, this deterrence is more closely related to the operation of the judicial system wherein the claim is raised. Thus, the award of fees to prevailing complainants depends only upon their success since the reasonableness of their opponents' litigation activities is irrelevant, while the award of fees to prevailing defendants depends upon the litigation misconduct of complaining parties.

23. *Marek*, 473 U.S. at 3-4.

24. *Id.* at 8.

25. *Id.* at 9 & n.2.

26. *Id.* at 9.

27. *Id.* at 11.

28. *Chesny v. Marek*, 720 F.2d 474, 479 (7th Cir. 1983), *rev'd*, 473 U.S. 1 (1985).

abling Act,²⁹ which disallows procedural rules from enlarging, modifying or abridging any substantive right.³⁰ This was true even though, in the absence of rule 68, attorney's fees were recoverable by the plaintiff under civil rights law.

The *Marek* decision illustrates that, in a separation of powers setting, a procedural law rule promulgated by a court may dictate attorney's fee allowances without contravening a substantive law right passed by a legislature. This general recognition of the availability of procedural fee-shifting laws initiated by courts with rulemaking power, although contrary to the results achieved when courts only consider substantive fee-shifting laws passed by legislatures, is equally applicable to settings involving a choice of law by a state court and the *Erie* doctrine. In all three settings, the substance/procedure dichotomy must be explored before there can be choices or adoption of fee-shifting provisions.

Marek demonstrates that, in a case with two relevant fee-shifting laws, one may be substantive and one may be procedural. It further evidences that the two different forms of fee-shifting laws may operate harmoniously in the same case. Beyond *Marek*, there are instances when a court can characterize a single fee-shifting provision as either substantive or procedural, depending upon the setting in which a court considers its use. *City of Carter Lake v. Aetna Casualty & Surety Co.*³¹ illustrates the dual characterizations attending some fee-shifting laws. The controversy in *Carter Lake* involved a diversity claim in a Nebraska federal court between Iowa and Nebraska concerns. Specifically, an insured sought payment under an insurance policy that was governed by Iowa law. In addition, the insured sought reimbursement of attorney's fees as provided by a Nebraska statute.³² Without articulating its reasoning, the federal court concluded that, for *Erie* purposes, the issue of granting or denying attorney's fees to the insured was a question of substantive law, and therefore state law, not federal law, controlled.³³ Sitting as a Ne-

29. 28 U.S.C. § 2072 (1982), quoted in part *infra* note 168.

30. *Marek*, 473 U.S. at 11. Compare *id.* at 36-38 (Brennan, J., dissenting).

31. 604 F.2d 1052 (8th Cir. 1979).

32. *Id.* at 1062. NEB. REV. STAT. § 44-359 (1974) generally provided that an uninsured who succeeds in obtaining a judgment is to be awarded attorney's fees. *Carter Lake*, 604 F.2d at 1052.

33. *Carter Lake*, 604 F.2d at 1062 (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941)). But see *State Sec. Ins. Co. v. White*, 498 F. Supp. 873, 874 (S.D. Ga. 1980) (recognizing that fee-shifting laws should not always be deemed substantive in an *Erie* setting), *aff'd without op.*, 667 F.2d 97 (5th Cir. 1982).

braska state court, the federal court then looked to Nebraska's approach to fee-shifting statutes involving insurance companies to determine whether Iowa or Nebraska law governed.³⁴ If the statute was substantive, Iowa law would control;³⁵ if procedural, Nebraska law would control.³⁶ The federal court examined Nebraska case law and determined that Nebraska characterized its fee-shifting statute as procedural and thus concluded that the Nebraska law controlled.³⁷ Accordingly, the federal court considered the Nebraska provision as substantive under *Erie*, but as procedural in a choice of state law setting.

In a somewhat different sense, a single fee-shifting law may be both substantive and procedural. Consider section 1988, the civil rights statute involved in *Marek*. In the lower court,³⁸ the judges remarked:

Although the right to attorney's fees created by section 1988 is in one sense not "substantive" but "procedural," because it governs the relations between the parties to a lawsuit, in another sense it is more "substantive" than "procedural." It does not make the litigation process more accurate and efficient for both parties [I]t is designed instead to achieve a substantive objective—compliance with the civil rights laws But no doubt the right is better described as both substantive and procedural, or as substantive for some purposes and procedural for others.³⁹

The court's remarks were appropriate because under section 1988 a prevailing complainant can recover fees regardless of the accuracy

34. *Carter Lake*, 604 F.2d at 1062.

35. *Id.*

36. *Id.*

37. *Id.* The court relied upon *Hawkeye Casualty Co. v. Stoker*, 154 Neb. 466, 48 N.W.2d 623 (1951). In *Hawkeye*, in the context of deciding a conflict of state law question, the Nebraska Supreme Court stated that "the authority to allow attorney's fees is procedural though in part controlled by statute." *Hawkeye*, 48 N.W.2d at 634. Of course, a state's characterization of a fee provision as substantive or procedural in such a setting should not be dispositive on the characterization of the state law for *Erie* purposes. Rather, the determination of whether a certain state law applies when a federal court hears a state law claim should be made only after consideration of the state's policies underlying its law "and their relation to accommodating the policy of the *Erie* rule with Congress' power to govern the incidents of litigation in diversity suits." *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 559 (1949) (Rutledge, J., dissenting).

38. *Chesny v. Marek*, 720 F.2d 474 (7th Cir. 1983), *rev'd*, 473 U.S. 1 (1985).

39. *Id.* at 479. While a prevailing plaintiff's right to recover fees under 42 U.S.C. § 1988 (1982) is substantive (as meritorious civil rights actions are encouraged), a prevailing defendant's right to recover fees under § 1988 is procedural (as bad faith litigation is deterred). See *supra* note 22.

and efficiency of the litigation process,⁴⁰ but a prevailing defendant can only recover fees if the complainant engages in significant litigation misconduct.⁴¹ Consequently, the statute embodies substantive civil rights law when used by a complainant, but procedural law on abusive litigation conduct when used by a defendant.

Accordingly, fee-shifting laws may be either procedural or substantive. Procedural fee-shifting laws typically govern conduct during litigation, often by permitting recovery of fees from those who abuse the judicial process. Substantive fee-shifting laws typically relate to the remedies available for certain claims, often encouraging assertions of these claims by providing that prevailing complainants are entitled to recovery of fees. *Marek* illustrates that a court can harmonize differing procedural and substantive fee-shifting laws. *Carter Lake* demonstrates that a court can characterize a single fee-shifting law as either procedural or substantive, depending upon the setting. Finally, section 1988 shows that a single fee-shifting law can contain both procedural and substantive law elements. Consequently, courts must closely examine fee-shifting laws, especially when they must choose from a variety of laws or make choices about the proper lawmaker.

While the substance/procedure dichotomy is significant in choosing from a variety of fee-shifting laws urged in a number of settings, and is even significant in applying a single fee-shifting law, the focus herein is fee-shifting in the *Erie* context. This Article argues that the policies of the *Erie* doctrine are fully applicable when federal courts must determine whether a particular fee provision should be given effect. Thus, in granting or denying a fee request under a state law, federal courts in the *Erie* setting must closely examine the state law and the implications surrounding its use. Bright line tests are inappropriate. As Justice Rutledge once noted:

[I]n many situations procedure and substance are so interwoven that rational separation becomes well-nigh impossible. But, even so, this fact cannot dispense with the necessity of making a distinction. For, as the matter stands, it is Congress which has the power to govern the procedure of the federal courts in diversity cases, and the states which have that power over matters clearly substantive in nature.⁴²

Unfortunately, many lower federal courts have failed to undertake a

40. *Christiansburg Garment Co. v. Equal Employment Opportunity Comm'n*, 434 U.S. 412, 421 (1978).

41. *Id.*

42. *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 559 (1949) (Rutledge, J., dissenting).

careful investigation of state and federal policies when fee-shifting laws clash in an *Erie* setting. Swayed by some unfortunate ambiguity in the Supreme Court's dicta in footnote 31 in *Alyeska*, many federal courts hearing state law claims have applied state fee-shifting provisions without analyzing their substantive or procedural nature.⁴³ Proper analysis of this substance/procedure dichotomy requires federal courts to distinguish between certain fee-shifting laws tied to varying claims, including those involving civil rights and insurance, and other fee-shifting laws tied to the judicial processes for resolving claims, including those involving pleading and motion practice. Such distinctions are necessary not only in an *Erie* setting, but also in settings involving state court choices between competing state laws and in settings involving choices about lawmakers when the legislature and courts share responsibility.

II. THE MISUNDERSTANDING OF SUPREME COURT PRECEDENT

A. *Supreme Court Decisions Prior to Alyeska*

Before considering the Supreme Court's dicta in footnote 31 in *Alyeska Pipeline Service Co. v. Wilderness Society*⁴⁴ and its unfortunate consequences, this Article first briefly examines earlier Supreme Court decisions. These cases are useful in approaching footnote 31 and in understanding its ramifications. The decisions suggest that, when sitting as state courts, federal courts need only apply state fee-shifting laws which are substantive, that is, the ones closely tied to the state laws on which the claims for relief are founded.

In 1928, in *Sioux County, Nebraska v. National Surety Co.*,⁴⁵ the Supreme Court confronted the issue of whether federal courts, in diversity cases, should enforce a state statute providing for the allowance of attorney's fees as costs, or whether the federal statutes which excluded these fees from permissible costs precluded such recovery.⁴⁶ A Nebraska statute mandated the allowance of attorney's fees "to be taxed as part of the costs" to a successful plaintiff in an action to recover on an insurance policy.⁴⁷ In applying the state statute, the Court distinguished between attorney's fees as costs and costs in the

43. See *infra* Part II.C.

44. 421 U.S. 240 (1975). See *infra* text accompanying notes 102-10.

45. 276 U.S. 238 (1928).

46. *Id.* at 243-44 (R.S. §§ 823, 824 dealing with the small fees of court officers, attorney's docket fees and the like, are now found at 28 U.S.C. §§ 1920, 1923 (1982)).

47. *Id.* at 242 n.2 (citing NEB. COMP. STAT. § 7811 (1922)).

ordinary sense. The Court viewed the allowance of attorney's fees as a state statutory right and concluded that federal courts should enforce such an allowance, not by taxing the amount as costs, but by including the attorney's fee in the judgment. The Court reasoned that such an allowance did not constitute costs in the ordinary sense, and therefore, the fees were not within the field of costs covered by federal statute.⁴⁸ The Court remarked:

Disregarding mere matters of form it is clear that it is the policy of the state to allow plaintiffs to recover an attorney's fee in certain cases, and it has made the policy effective by making the allowance of the fee mandatory on its courts in those cases. It would be at least anomalous if this policy could be thwarted and the right so plainly given destroyed by removal of the cause to the federal courts.⁴⁹

This statement, often quoted by federal courts in later *Erie* cases, is an early source of the misunderstanding regarding the applicability of state fee-shifting laws in federal courts. Some courts have broadly interpreted the language in *Sioux County* as mandating that federal courts give effect to all state fee-shifting laws. Yet, a review of cases involving fee-shifting laws in an insurance context, as occurred in *Sioux County*,⁵⁰ demonstrates that such a broad interpretation is inappropriate. Judge Strum, in *Orlando Candy Co. v. New Hampshire Fire Insurance Co.*,⁵¹ recognized that the liability imposed upon an insurer by a statute like that involved in *Sioux County* "is in effect an incident to the insurer's wrongful refusal to pay, not a mere procedural incident to the entry of judgment."⁵² The judge reasoned that such a statute "in effect becomes a part of the contract, because the parties contract subject to the terms of the statute."⁵³ Furthermore, it is significant to note that, in *Sioux County*, the Supreme Court's concern focused on preserving the insured's unfettered state law right to compensation for attorney's fees and not on the insured's right to be compensated at the court's discretion for certain costs associated with litigation.⁵⁴ Although the Court in *Sioux County* did not expressly characterize this right as substantive, the district court in *Orlando* ex-

48. *Id.* at 243-44. Of course, several years later the Court's reasoning would have been guided by its decision in *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938).

49. *Sioux County*, 276 U.S. at 243.

50. *Id.*

51. 51 F.2d 392 (D. Fla. 1931).

52. *Id.* at 393.

53. *Id.*

54. *Sioux County*, 276 U.S. at 243-44.

plained the nature of an insured's right to compensation for attorney's fees as follows:

The statute imposes a liability for . . . delinquency on the part of an insurer in the payment of its obligation. A corresponding right of recovery necessarily arises in favor of the beneficiary. The right thus created . . . is a substantive right The parties having contracted with reference to the statute, the substantive right clearly exists in a prevailing plaintiff to recover reasonable attorney's fees.⁵⁵

Thus, courts can only interpret *Sioux County* as requiring federal courts hearing state law claims to apply state substantive (contract or insurance) laws on fee-shifting and not all state fee-shifting laws.

More recently, the Supreme Court of Appeals of West Virginia also elaborated on the protective policies furthered by fee-shifting laws on behalf of an insured. In *Hayseeds, Inc. v. State Farm Tire & Casualty*,⁵⁶ the West Virginia court considered the state common law right to attorney's fees for prevailing complainants in property damage insurance claims. The court observed the following: (1) both policy holders and third-party creditors rely upon an insured's policy; (2) an insurance company is in a superior bargaining position to the insured; and (3) when an insured's property, whether his residence or commercial structure, is destroyed, he has an urgent need to rebuild.⁵⁷ On the latter point the court stated, "In the case of a business, lack of immediate rebuilding may cost the company a significant portion of its skilled employees and may cause employees the loss of their jobs, pensions, and seniority."⁵⁸ After acknowledging the American Rule, the court stated, "[I]n the absence of a statutory or contractual provision providing for such recovery, attorneys' fees may not be recovered in an action on an insurance policy."⁵⁹ The court reaffirmed West Virginia's agreement with other jurisdictions which recognize the role of fee-shifting in promoting prompt payments of insurance.⁶⁰ In addition, the court established a bright line test, deeming the insurer's good or bad faith either before or after litigation as irrelevant. It declared, "After all, the insurer had contracted to defend the insured, and it failed to do so. It guessed wrong as to its duty, and should be

55. *Orlando*, 51 F.2d at 393. Judge Strum's opinion pre-dated the decision in *Erie*.

56. 352 S.E.2d 73 (W. Va. 1986).

57. *Id.* at 77.

58. *Id.* at 77-78.

59. *Id.* at 78 (citing 22A J. APPLEMAN, INSURANCE LAW AND PRACTICE, § 14533 (Appleman ed. 1979); 15A COUCH ON INSURANCE 2d § 58:124 (Rhodes ed. 1983)).

60. *Id.* at 79.

compelled to bear the consequences thereof.”⁶¹ Noting that a policy holder buys insurance, not a vexatious or expensive lawsuit, the *Hayseeds* court remarked that when an insurer breaches its contractual duty to defend its insured, it should be compelled to compensate the insured for all expenses resulting from the breach of contract.⁶²

The opinion in *Sioux County* is consistent with *Orlando* and *Hayseeds*. The *Sioux County* Court asserted that a statutory liability for paying attorney's fees, which is an incident of one party's wrongful refusal to perform an obligation owed to the other party and not a mere procedural incident to the entry of the judgment, gives rise to a corollary substantive right to the recovery of attorney's fees incurred in the enforcement of that obligation.⁶³ Implicit in this assertion is that a liability to compensate an opponent for his attorney's fees, which is imposed merely as a procedural incident to the entry of judgment, does not give rise to a substantive right although it creates a corresponding right of recovery.

Thus, *Sioux County* recognizes that a fee-shifting law creates a liability to compensate and a corresponding right to receive compensation. In determining the applicability of a particular fee-shifting law in an *Erie* setting, the pre-*Erie* decision in *Sioux County* directs federal courts to focus on the nature of the liability that the fee-shifting law imposes. Federal courts must consider whether the fee-shifting law imposes liability merely as a procedural device, thus creating as an incident a corresponding right to recover fees, or whether the liability goes beyond procedural concerns and creates in the prevailing party a substantive right to compensation. *Sioux County* requires application of only state fee-shifting laws which impose liabilities that are not merely incidental to the management of adjudication. Accordingly, federal courts hearing state law claims should only apply state fee-shifting laws which are substantive.

Five years after *Sioux County*, the Supreme Court, in *Missouri State Life Insurance Co. v. Jones*,⁶⁴ considered whether the allowance of attorney's fees should be included as part of the amount in controversy needed to remove a diversity case to federal district court. An Arkansas statute allowed attorney's fees to persons seeking to collect

61. *Id.* (quoting 7C J. APPLEMAN, INSURANCE LAW AND PRACTICE, § 4691, at 282-83 (Berdal ed. 1979)).

62. *Id.* The *Hayseeds* court noted that insureds could also recover punitive damages if the insurer maliciously intended to injure or defraud the insured. *Id.* at 80.

63. *Sioux County, Neb. v. National Sur. Co.*, 276 U.S. 238, 243 (1928).

64. 290 U.S. 199 (1933).

payments under insurance policies.⁶⁵ The state court had denied removal, ruling that the Arkansas statute required attorney's fees to be taxed as costs and that costs were not computed in valuing the matter in controversy.⁶⁶ The Supreme Court reversed, relying on *Sioux County* for two propositions: first, a state statute permitting attorney's fees as costs creates a liability which is enforceable in a federal court; and second, although the statute characterizes the allowance as costs, the characterization does not affect the nature of liability.⁶⁷ Although this broad language might urge the conclusion that all state statutes permitting attorney's fees as costs are enforceable in a federal court, this conclusion is not correct. The Court, in *Missouri State*, further declared:

In the state court the present respondent sought to enforce the liability imposed by statute *for his benefit*—to collect something to which the law gave him a right. The amount so demanded became part of the matter put in controversy by the complaint, and not mere "costs" excluded from the reckoning by the jurisdictional and removal statutes.⁶⁸

Thus, the Court expressly acknowledged that the statute imposed liability for the benefit of the insured. This liability was unrelated to any litigation activity. The liability was not a mere procedural incident to the entry of the judgment under *Sioux County*; rather, it constituted a part of state substantive insurance law.

In 1949, the Supreme Court, in an *Erie* setting, confronted a New Jersey statute⁶⁹ that required certain unsuccessful plaintiffs in

65. The statute stated:

In all cases where loss occurs, and the fire, life, health, or accident insurance company liable therefor shall fail to pay the same within the time specified in the policy, after demand made therefor, such company shall be liable to pay the holder of such policy, in addition to the amount of such loss, twelve per cent damages upon the amount of such loss, together with all reasonable attorneys' fees for the prosecution and collection of said loss; said attorneys' fees to be taxed by the court where the same is heard on original action, by appeal or otherwise and to be taxed up as part of the costs therein and collected as other costs are or may be by law collected.

Id. at 200 (quoting Crawford & Moses' Digest, Statutes of Arkansas § 6155).

66. *Id.* at 201. Of course, today state courts have no power to rule on the propriety of removal from state to federal court. See 28 U.S.C. § 1447 (1982).

67. *Missouri State*, 290 U.S. at 202.

68. *Id.* (emphasis added). This language was seemingly properly applied in *Batts Restaurant, Inc. v. Commercial Ins. Co.*, 406 F.2d 118, 120 (7th Cir. 1969) (utilizing act which permitted fees against an insurer who refused to pay in order to establish jurisdictional amount) and was misapplied in *Velez v. Crown Life Ins. Co.*, 599 F.2d 471, 474 (1st Cir. 1979) (utilizing state laws allowing fees against defendants who refuse to settle any claim in order to calculate amount in controversy for federal jurisdictional purposes).

69. The statute stated:

shareholder derivative suits to pay the defending corporation's reasonable defense expenses, including attorney's fees. The statute further required these plaintiffs to give security for any such future payments as a prerequisite to bringing the action. The Court, in *Cohen v. Beneficial Industrial Loan Corp.*,⁷⁰ held that the statute should be enforced.⁷¹ Justice Jackson, writing for the majority, reasoned that a shareholder commencing a derivative suit "is a self-chosen representative and a volunteer champion"⁷² of all the shareholders, and as such, "assumes a position . . . of a fiduciary character."⁷³ Furthermore, Justice Jackson argued that fiduciary litigation is extremely susceptible to regulation⁷⁴ and "that the state has plenary power over this type of litigation."⁷⁵ In finding that the state has the power to prohibit derivative suits if plaintiffs do not give security required by state statute, Justice Jackson observed that the security requirement is

1. In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class . . . unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars (\$50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgement, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive.

2. In any action, suit or proceeding brought or maintained in the right of a domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation, it must be made to appear that the complainant was a shareholder or the holder of a voting trust certificate at the time of the transaction of which he complains or that his share or voting trust certificate thereafter devolved upon him by operation of law.

3. This act shall take effect immediately and shall apply to all such actions, suits or proceedings now pending in which no final judgment has been entered, and to all future actions, suits and proceedings.

Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 544 n.1 (1949) (quoting N.J. LAWS 131 (current version at N.J. STAT. ANN. § 14A:3-6 (West Supp. 1987))).

70. 337 U.S. 541 (1949).

71. *Id.* at 556.

72. *Id.* at 549.

73. *Id.*

74. *Id.* at 552.

75. *Id.* at 550.

a legitimate means of ensuring that unsuccessful plaintiffs can satisfy any resulting liability for fees.⁷⁶

In response to the argument that the New Jersey statute was procedural, and therefore, inapplicable in federal court,⁷⁷ Justice Jackson suggested that under *Erie Railroad v. Tompkins*⁷⁸ and *Guaranty Trust Co. v. York*,⁷⁹ federal courts might be required to apply state procedural law when the law does something more than regulate procedure.⁸⁰ He then remarked that the New Jersey statute did more than merely regulate procedure because it created a new liability—an unsuccessful plaintiff in a derivative suit became accountable to the corporation for its expenses. Justice Jackson found this liability to be unusual and to transcend the payment of costs. The provision requiring security added “meaning and value” to the liability requirement.⁸¹ Hence, the Supreme Court determined that federal courts were unable to disregard the New Jersey liability statute as procedural.⁸²

The Court further held that Federal Rule of Civil Procedure 23⁸³ concerning derivative actions did not preclude application of the New

76. *Id.* at 552, 556. Found comparable in an *Erie* setting was an Oregon statute seeking to assure that costs assessed against nonresident or foreign defendants be paid (through establishment of duties on the defendant's attorney). See *In re Merrill Lynch Relocation Management, Inc.*, 812 F.2d 1116 (9th Cir. 1987).

77. *Cohen*, 337 U.S. at 555.

78. 304 U.S. 64 (1938).

79. 326 U.S. 99, 104-05 (1945) (State statute of limitations was applicable in a federal diversity suit in equity although a federal statute, 28 U.S.C. § 723, provided that “the forms and modes of proceeding in suits . . . of equity” would conform to the settled uses of courts of equity.”).

80. *Cohen*, 337 U.S. at 555 (“Rules which lawyers call procedural do not always exhaust their effect by regulating procedure.”).

81. *Id.* at 556.

82. *Id.* This broad view of what is meant by substantive under the *Erie* doctrine has unfortunately been interpreted by some courts to mean that all state rules which allow fee-shifting create a substantive right which federal courts are to recognize, merely because the law “creates a new liability.” Thus, in *Pan Am. World Airways, Inc. v. Ramos*, 357 F.2d 341 (1st Cir. 1966), the court upheld a grant of fees made pursuant to P.R. R. Civ. P. 44.4(D), which allowed assessment of attorney's fees against a party who had been “obstinate” during litigation. *Ramos*, 357 F.2d at 342. The court, citing *Cohen*, recognized rule 44.4(D) as “a matter of substantive right,” though it failed to articulate how the rule did more than merely regulate procedure. *Id.* See *Betancourt v. J. C. Penney Co.*, 554 F.2d 1206 (1st Cir. 1977). Under *Cohen*, procedural rules intimately tied to the ability to collect on the violation of substantive rights are distinguished from procedural rules having little to do with the “meaning and value” of substantive rights. *Cohen*, 337 U.S. at 556. Thus, the Court in *Cohen* conceded that the Federal Rule on derivative actions would apply, though in conflict with other state procedural laws, since matters covered therein had little to do with the liabilities under New Jersey substantive law. *Id.*

83. FED. R. CIV. P. 23. At the time, the rule required a stockholder's complaint to be verified by oath, to show plaintiff's timely ownership of relevant stock, to demonstrate the lack of collusion regarding jurisdiction, and to set forth facts demonstrating an attempt to secure relief from the

Jersey statute in federal court. The provisions of the Federal Rule simply required notice to parties and disclosure to the court. The Court held that because the Federal Rule provisions "neither create nor exempt from liabilities,"⁸⁴ they do not conflict with the state statute, and thus, in accordance with *Guaranty Trust*, the state statute should be applied.⁸⁵ In other words, the New Jersey state law claim brought as a derivative action would be governed by both New Jersey statutes and federal procedural rules on derivative lawsuits.⁸⁶

Justice Douglas, dissenting in part, expressed a narrower view of what is meant by "substantive" under the *Erie* doctrine. While the majority opinion perceived a substantive quality to the New Jersey statute because it created "a new liability where none existed before,"⁸⁷ Justice Douglas found that the New Jersey statute only regulated the procedure for bringing a derivative suit and did not fall within the *Erie* doctrine because it did not "define, qualify or delimit the cause of action or otherwise relate to it."⁸⁸ While Justice Douglas disagreed with Justice Jackson's application of the *Erie* doctrine, he seemingly did not dispute the majority's statement of principles.

In his dissent, Justice Rutledge noted that the *Erie* doctrine required federal courts to apply state common law and statutory law "in determining matters of *substantive* law, in particular and apart from procedural limitations upon its assertion—whether a cause of action exists."⁸⁹ He then observed that post-*Erie* decisions such as *Guaranty Trust* had extended the *Erie* doctrine to the point of impairing Congress' power to control litigation in federal courts.⁹⁰ Justice Rutledge continued by declaring that, in many instances, substance

corporation. *Cohen*, 337 U.S. at 556. None of the rule provisions were found to conflict with the state statute. *Id.* The relevant Federal Rule is now FED. R. CIV. P. 23.1.

84. *Cohen*, 337 U.S. at 556.

85. *Id.* (citing *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945)). The Court in *Cohen* noted that state law should be applied by federal courts in diversity cases in all instances "except details related to its own conduct of business." *Id.* at 555 (citing *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945)).

86. Presumably, only New Jersey derivative action law with a "substantive tinge" would apply. *Id.* at 561 (Rutledge, J., dissenting). While such a categorization is often difficult, evidently a majority in *Cohen* found that laws on attorney's fees and security for expenses regulated the relationships between corporations and their shareholders and between a stockholder fiduciary and those whom he represents, and did not regulate the conduct of litigation. *Id.* at 549-50.

87. *Id.* at 555.

88. *Id.* at 557 (Douglas, J., dissenting in part). Justice Douglas remarked that the New Jersey statute neither added nor subtracted one iota from the cause of action. *Id.*

89. *Id.* at 558 (Rutledge, J., dissenting) (emphasis added).

90. *Id.* at 559.

and procedure had become so interwoven that it was difficult for courts to make a distinction. However, Justice Rutledge argued that the need to make the distinction existed nonetheless since, in *Erie* cases, states have power over clearly substantive matters while Congress has power over clearly procedural matters.⁹¹

Justice Rutledge proceeded by noting that the substance/procedure distinction should not be made "mechanically by reference to whether the state courts' doors are open or closed, . . . [but rather] by a consideration of the policies which close them and their relation to accommodating the policy of the *Erie* rule with Congress' power to govern the incidents of litigation in diversity suits."⁹² According to Justice Rutledge, the Federal Rule should have governed the case because, even if the New Jersey statute created a right of recovery, the state statute was more procedural than substantive as it controlled the incidents of litigation more than the outcome of litigation.⁹³ For Justice Rutledge, the Federal Rule requirement that a plaintiff must aver in his complaint that at the time of the transaction giving rise to the derivative suit he was a shareholder, or that following the transaction his share devolved by operation of law, was just as "substantive" as the New Jersey requirement that certain plaintiffs in such suits give security.⁹⁴ If this were true, he reasoned, then "any automatic or mechanical application of the substance-procedural dichotomy"⁹⁵ would likely foreclose Congress or the Supreme Court from creating a limitation on diversity litigation, such as in the Federal Rule for pleading claims and for sanctions—including attorney's fees—on violations thereof, since state law governed substantive matters.⁹⁶ He concluded that, notwithstanding its substantive tinge, the Federal Rule was valid and applicable because it was so "closely related to procedural and other matters affecting litigation in federal courts"⁹⁷ and because the New Jersey law, even though it may have had a substantive aspect, was too closely related to the manner in which litigation was to be conducted. Justice Rutledge concluded that the state law should not be permitted to infringe upon Congress' power to reg-

91. *Id.*

92. *Id.*

93. *Id.* at 560-61.

94. *Id.* at 561.

95. *Id.*

96. *Id.*

97. *Id.*

ulate modes and methods of conducting litigation in federal courts.⁹⁸

Regardless of whether or not the *Cohen* majority correctly concluded that the New Jersey fee-shifting law and the related security requirement were sufficiently substantive to require enforcement by federal courts, it is significant that this question formed the cornerstone for each of the opinions in the case. No Justice assumed all state fee-shifting laws would apply in an *Erie* setting. Justice Jackson described a stockholder bringing a derivative action as a fiduciary of his fellow stockholders.⁹⁹ Thus, he perceived the state statute as effectuating a goal beyond the arguably procedural objectives of protecting corporations from "strike suits"—derivative suits brought to harass and not to redress wrongs.¹⁰⁰ The statute imposed liability on a stockholder who brought a derivative suit and the Supreme Court regarded this liability as an incident of the stockholder's breach of a fiduciary duty to his fellow stockholders in undertaking action on their behalf. Accordingly, liability was not merely a procedural device regulating conduct between adversaries during litigation. Justice Rutledge found that the state laws had a substantive tinge which was insufficient under *Erie Railroad v. Tompkins*,¹⁰¹ while Justice Douglas found the state laws insufficiently related to the cause of action.

Consequently, federal courts may interpret the pre-*Alyeska* Supreme Court decisions directing federal courts to apply various state fee-shifting laws in an *Erie* setting as requiring them only to give effect to state substantive fee-shifting laws. Not all state fee-shifting laws must be enforced when federal courts entertain state law claims.

B. Footnote 31 in *Alyeska*

The foregoing cases comprised the major fee-shifting precedents before the Supreme Court in 1975. They suggested that federal courts hearing state law claims must apply many, but not all, state fee-shift-

98. *Id.* at 549. While Justice Rutledge's analysis has some appeal, ultimately his conclusion seems wrong. The New Jersey statute on fees and security was meant to limit the enforcement opportunities for specific causes of action of specific people long before litigation had begun, though based on earlier instances of abuses by similar people. *Id.* at 548 (concern for "strike suits"). A contemporary analogy may be found in states with procedural laws on pleading abuse covering all forms of civil litigation and substantive laws protective of certain parties in certain types of lawsuits. ILL. REV. STAT. ch. 110, §§ 2-611, 2-611.1, 2-622 (Smith-Hurd Supp. 1987) (the former concerns all pleadings, the others only medical malpractice defendants whom the legislature determined should not be easily sued).

99. *Cohen*, 337 U.S. at 549.

100. *Id.* at 548.

101. 304 U.S. 64 (1938).

ing laws. Unfortunately, the Supreme Court in 1975 did not follow these precedents.

In *Alyeska Pipeline Service Co. v. Wilderness Society*,¹⁰² the Supreme Court examined the propriety of an award of attorney's fees based on the equitable powers of the federal courts and the theory that the plaintiffs acted as a "private attorney general."¹⁰³ The Court reviewed the American Rule and decided that Congress alone should usually determine the circumstances and manner of awarding attorney's fees.¹⁰⁴ Consequently, judicial recognition of a private attorney general exception to the American Rule would invade the province of Congress.¹⁰⁵ Alluding to the few instances in which the Court permitted fees to the prevailing party in the absence of statutory authority,¹⁰⁶ the Court stated that those exceptions were based upon the inherent judicial authority to allow attorney's fees in specific instances in the absence of a congressional prohibition. The Court declared, however, that no such exception applied in the pending case.¹⁰⁷ Because its conclusion occurred in a case involving a federal question, rather than diversity jurisdiction, and because differentiations between federal and state law claims were crucial in determining requests for attorney's fees, the Court elaborated on the distinction between fee allowances in the two settings in footnote 31. In distinguishing federal courts entertaining federal law claims and federal

102. 421 U.S. 240 (1975).

103. *Id.* at 241. Private environmental protection groups brought this suit in an attempt to prevent construction of an oil pipeline. Although there was no applicable statute allowing an award of attorney's fees, the court of appeals nevertheless determined that suit had been brought to vindicate "important statutory rights of all citizens." *Id.* at 245 (quoting *Wilderness Soc'y v. Morton*, 495 F.2d 1026, 1032 (D.C. Cir. 1974) (en banc), *rev'd sub nom.* *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240 (1975)). The *Alyeska* Court also determined that allowance of attorney's fees would encourage private parties to seek enforcement of environmental protection laws. *Id.* at 245-46.

104. Specific authority from Congress was usually required because fee-shifting laws were found to involve conflicting public policy views and because there were no judicially manageable standards for resolving such conflicts. *Id.* at 264 n.39.

105. *Id.* at 271.

106. *Id.* at 257-59. The *Alyeska* Court recognized the historic equitable power to allow a trustee of a fund or property, or a party preserving or recovering a fund for the benefit of others in addition to himself, to recover attorney's fees whether from the fund or property itself or directly from the other parties who benefit, *id.* at 257 (citing *Trustees v. Greenough*, 105 U.S. 527 (1881)); the power to assess attorney's fees for the willful disobedience of a court order as part of the fine to be levied on the defendant, *id.* at 258 (quoting *Toledo Scale Co. v. Computing Scale Co.*, 261 U.S. 399, 426-28 (1923)); and the power to allow attorney's fees when a losing party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons. *Id.* at 258-59 (citing *F. D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 129 (1974)).

107. *Id.* at 259.

courts entertaining state law claims, the Court first cited secondary authorities, including works by Professor James Moore and Stuart Speiser:

A very different situation is presented when a federal court sits in a diversity case. "[I]n an ordinary diversity case where the state law does not run counter to a valid federal statute or rule of court, and usually it will not, state law denying the right to attorney's fees or giving a right thereto, which reflects a substantial policy of the state, should be followed."¹⁰⁸

The *Alyeska* Court, in footnote 31, next referred to its own cases on federal court responsibility during the resolution of state law claims, concluding with the last major case, *Hanna v. Plumer*:¹⁰⁹

Prior to the decision in *Erie R. Co. v. Tompkins* this Court held that a state statute requiring an award of attorneys' fees should be applied in a case removed from the state courts to the federal courts: "[I]t is clear that it is the policy of the state to allow plaintiffs to recover an attorney's fee allowance of the fee mandatory on its courts in those cases. It would be at least anomalous if this policy could be thwarted and the right so plainly given destroyed by removal of the cause to the federal courts." *People of Sioux County v. National Surety Co.* The limitations on the awards of attorneys' fees by federal courts deriving from the 1853 Act were found not to bar the award. We see nothing after *Erie* requiring a departure from this result. See *Hanna v. Plumer*. The same would clearly hold for a judicially created rule, although the question of the proper rule to govern in awarding attorneys' fees in federal diversity cases in the absence of state statutory authorization loses much of its practical significance in light of the fact that most States follow the restrictive American rule.¹¹⁰

108. *Id.* at 259 n.31 (quoting 6 J. MOORE, FEDERAL PRACTICE ¶ 54.77[2], at 1712-13 (2d ed. 1974)).

109. 380 U.S. 460 (1965).

110. *Alyeska*, 421 U.S. at 259 n.31. (citations omitted). Incidentally, there are cases which may not be based on diversity jurisdiction, but to which this should apply. These cases involve the exercise of pendent or ancillary jurisdiction. See, e.g., *United Mine Workers of Am. v. Gibbs*, 383 U.S. 715 (1966); 28 U.S.C. § 1338(b) (1982). Federal courts generally acknowledge that the principles of *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938) apply to pendent and ancillary claims as well as to claims in diversity. See *Mintz v. Allen*, 254 F. Supp. 1012, 1013 (S.D.N.Y. 1966). See also *McGinty v. Beranger Volkswagen, Inc.*, 633 F.2d 226, 232 (1st Cir. 1980) (stating that the same reasons for giving effect to state laws in diversity cases apply to pendent jurisdiction cases); *United States ex rel. Garrett v. Midwest Constr. Co.*, 619 F.2d 349, 352-53 (5th Cir. 1980) (allowing fees pursuant to Texas law for a state claim removed and consolidated with the federal claim). Because pendent and ancillary jurisdiction, like diversity of citizenship jurisdiction, involve somewhat fortuitous federal court responsibility, the policies favoring uniformity and disfavoring forum shopping are important. Therefore, state substantive laws regarding fee-shifting should govern pendent and ancillary claims. But see *Time Mechanisms, Inc. v. Qonaar Corp.*, 422 F. Supp. 905, 916 (D.N.J. 1976) (denial of

C. *The Misreading of Footnote 31 by Lower Courts*

Lower federal courts have seriously misinterpreted footnote 31 in *Alyeska*, as well as earlier Supreme Court cases, in determining which state fee-shifting laws should govern in an *Erie* setting. They should interpret the phrase in footnote 31, "state law . . . which reflects a substantial policy of the state,"¹¹¹ to compel deference only to state substantive law. Therefore, state laws on attorney's fees which are procedural in nature are inapplicable in *Erie* cases. Lower federal courts sitting as state courts should not utilize footnote 31 as authority for applying all state fee-shifting laws in an *Erie* setting, but must distinguish between substantive and procedural fee-shifting provisions.

In misreading footnote 31, federal courts sitting as state courts have occasionally applied state procedural fee-shifting laws. One type of state procedural law on attorney's fees which federal courts have applied in an *Erie* setting was exemplified by section 41 of the Illinois Civil Practice Act¹¹² (section 41). This statute permitted a party to recover fees incurred as a result of false pleadings unreasonably made by an opponent in bad faith.¹¹³ The Seventh Circuit Court of Appeals considered section 41 in *Tryforos v. Icarian Development Co.*¹¹⁴ and denied a request for attorney's fees. The court's denial was not based upon a determination that section 41 was procedural and therefore inapplicable in federal court. Indeed, the court drew no distinction between state fee-shifting laws which do and do not reflect a substantial policy of the state. Rather, the circuit court held that the district court's findings did not indicate that the suit was brought unreasona-

attorney's fees under a substantive state law on ground that federal jurisdiction over the state claim was pendent and not based on diversity).

111. *Alyeska*, 421 U.S. at 259 n.31.

112. ILL. REV. STAT. ch. 110, § 41 (1973) provided:

Allegations and denials, made without reasonable cause and in good faith, and found to be untrue, shall subject the party pleading them to the payment of reasonable expenses, actually incurred by the other party by reason of the untrue pleading, together with a reasonable attorney's fee, to be summarily taxed by the court at trial.

With very recent amendments, the Illinois law now substantially conforms to FED. R. CIV. P. 11. See ILL. REV. STAT. ch. 110, § 2-611 (Smith-Hurd Supp. 1987).

113. ILL. REV. STAT. ch. 110, § 41 (1973).

114. 518 F.2d 1258 (7th Cir. 1975), *cert. denied sub nom.* Manta v. Tryforos, 423 U.S. 1091 (1976). The Seventh Circuit Court of Appeals also considered § 41 in *Royal Indem. Co. v. Kenny Constr. Co.*, 528 F.2d 184 (7th Cir. 1975), *cert. denied sub nom.* City of Chicago v. Kenny Constr. Co., 426 U.S. 921 (1976). Citing *Erie*, the *Royal* court stated, "In diversity actions, state law governs." *Id.* at 190 n.9 (citing *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938)). The court did not distinguish between state substantive and procedural law.

bly or in bad faith, and thus the relevant conduct did not fall within section 41.¹¹⁵ The defendant argued that the lower court's award of fees was nonetheless supportable under the federal law exception to the American Rule. That exception allows attorney's fees when an opponent acts in an "oppressive and vexatious manner" and unnecessarily prolongs prosecution of the action.¹¹⁶ Citing footnote 31, the circuit court rejected the defendant's argument and concluded, "Thus, it is to state law that the district courts must look in determining whether attorneys' fees may be awarded in a diversity case."¹¹⁷

115. *Tryforos*, 518 F.2d at 1266-67.

116. *Id.* at 1265 n.27. For other exceptions, see *supra* note 106.

117. *Tryforos*, 518 F.2d at 1265 n.27. This broad reading of footnote 31 by federal courts has led to two unfortunate results: federal courts are not only interpreting footnote 31 as mandating application of all state fee-shifting provisions in *Erie* cases, but also, as in *Tryforos*, they are interpreting it as requiring the exclusion of federal procedural common law allowing fee-shifting. See *Chicago Regional Port Dist. v. Ferroslog, Inc.*, 531 F. Supp. 401, 402 (N.D. Ill. 1982) (federal district court, sitting in diversity, held that it was without power to invoke the federal bad faith exception for awarding fees). This misconception is not unique to the Seventh Circuit. See, e.g., *First State Underwriters Agency v. Travelers Ins. Co.*, 803 F.2d 1308, 1313 (3d Cir. 1986) (employing state fee-shifting law in diversity case for bad faith during litigation where law applied to all litigants); *Perkins State Bank v. Connolly*, 632 F.2d 1306, 1310 (5th Cir. 1980) (holding that federal bad faith exception to American Rule does not allow fee recovery in an interpleader case unless state law also recognizes the exception). These misreadings impinge upon the federal power to regulate procedure in federal courts. See *infra* text accompanying notes 153-99. Unfortunately, some federal courts in diversity cases have failed to undertake the necessary *Erie* analysis to determine the applicability of federal procedural common law, and have instead simply relied upon footnote 31 for the proposition that where a state does not recognize a bad faith exception to the American Rule, federal courts may not invoke any federal common law. See *infra* text accompanying notes 147-52. The *Erie* analysis, however, reveals this reliance to be erroneous. Although application of the bad faith exception may result in disparate treatment of a bad faith litigant in federal court and in state court, this lack of uniformity regarding assessment of attorney's fees is unlikely to promote forum shopping. It is improbable that a litigant would choose a federal forum in hope of recovering counsel's fees in the remote prospect that the opponent will conduct himself in bad faith and still not fall within any federal statute or procedural rule. Furthermore, the bad faith exception has no bearing on the outcome of the case; it simply regulates the manner in which substantive rights may be enforced in federal court. As well, the federal interest in deterring misconduct in federal courts through sanctions, such as those imposed under the bad faith exception to the American Rule, does not conflict with the policy of states adhering to a different rule. For a similar analysis, see *id.* See also *Marek v. Chesny*, 473 U.S. 1 (1985) (discussing the compatibility between federal procedural common law designed to streamline litigation and any state substantive law designed to encourage meritorious litigation); *Shimman v. International Union of Operating Eng'rs, Local 18*, 744 F.2d 1226, 1231-32 (6th Cir. 1984) (discussing American Rule disallowing attorney's fees as part of compensation, and federal common law bad faith exception to American Rule). See also *supra* notes 20-30 and accompanying text.

Federal courts' recognition of the applicability of the federal procedural bad faith exception to the American Rule for state law claims, as well as for federal question claims, serves the goal of creating certainty as to the conduct and circumstances that will trigger fee awards in federal courts. The procedural bad faith exception derives from federal court authority "governed not by rule or statute but by the control necessarily vested in courts to manage their own affairs so as to achieve the

The court never discussed whether the asserted federal law exception to the American Rule was substantive or procedural.¹¹⁸

A Florida statute illustrates a second form of state procedural

orderly and expeditious disposition of cases." *Link v. Wabash R.R.*, 370 U.S. 626, 630-31 (1962) (affirming district court's sua sponte dismissal of diversity case for lack of prosecution pursuant to district court's inherent housekeeping power). See *Howard v. Chris-Craft Corp.*, 562 F. Supp. 932, 940-41 (E.D. Tex. 1982) (although court sitting in diversity considered whether defendant's litigation conduct was in bad faith so as to warrant exercise of court's equitable power to award plaintiffs their attorney's fees, it incorrectly applied federal bad faith exception regarding prelitigation conduct and properly deferred to Texas statute on service, labor and other contracts).

118. Interestingly, in *Chicago Regional Port Dist. v. Ferroslog, Inc.*, 531 F. Supp. 401 (N.D. Ill. 1982), a district court held that it was without power to award attorney's fees pursuant to the federal bad faith exception in a diversity case. Yet in *Knorr Brake Corp. v. Harbil, Inc.*, 556 F. Supp. 484 (N.D. Ill. 1983), *rev'd*, 738 F.2d 223 (7th Cir. 1984), the same court sitting in diversity invoked 28 U.S.C. § 1927 to assess attorney's fees against Harbil's counsel:

Any attorney or other person admitted to conduct cases in any court of the United States or any territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

28 U.S.C. § 1927 (1982).

This raises the question of why the court in *Ferroslog* held that it was without authority to assess fees against a party via the federal common law bad faith exception, but the court in *Knorr* held that it had the authority to assess fees against attorneys under a federal statute. Is the attorney/client or statutory/common law difference important? Citing its own dicta in *Ferroslog*, the court in *Knorr* stated that § 1927 permitted the assessment of fees against lawyers in all federal court actions. *Knorr*, 556 F. Supp. at 486 n.3. The court believed there was a more compelling federal interest in sanctioning attorney misconduct than in sanctioning party misconduct. This notion is erroneous because federal policy is to sanction misconduct of both parties and attorneys alike. Federal Rules 11 and 26, which provide for sanctions against either parties or lawyers, are demonstrative of this policy. See also *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 765-66 (1980) (indicating that line of "inherent power" cases suggests that clients and attorneys alike may be sanctionable for misconduct).

Another possible explanation of why the district court felt it was authorized to invoke § 1927, but not the common law bad faith exception, involves the distinct tests articulated in *Hanna v. Plumer*, 380 U.S. 460 (1965). The test for applying federal civil rules (and presumably federal procedural law statutes) in diversity cases is whether the rules are proper subjects for federal governmental concern (both the concern defined by statute, such as due regard for substantive rights found in 28 U.S.C. § 2072 (1982), and the concern defined by the federal Constitution). *Hanna*, 380 U.S. at 469-74. The test for applying federal common law in diversity cases involves the *Erie* concerns for forum shopping and uniformity. *Id.* at 473. See also *infra* text accompanying notes 142-47. Most courts mistakenly proceed as though the *Erie* concerns were authoritatively addressed in footnote 31 in *Alyeska*. See *supra* note 117 and accompanying text.

The foregoing analysis suggests the advisability of harmonizing the procedural laws in rule 11, § 1927, and the bad faith exception by consolidating them into a unified standard, preferably set out in federal rules. Consolidation would clarify the confusion as to when one or the other is applicable and would better assure uniform treatment of similar process abuses. See, e.g., Parness, *Groundless Pleadings and Certifying Attorneys in the Federal Courts*, 1985 UTAH L. REV. 325, 356-62. Guidelines unrelated to procedural law concerns and thus usually applicable in federal question cases would remain as federal common law exceptions to the American Rule against fee-shifting. See *supra* note 106.

law on fee-shifting which is broader in scope and yet also deemed applicable in an *Erie* setting. The state statute provides that a court can award attorney's fees to a prevailing party when the court determines that the losing party failed to raise a justiciable issue.¹¹⁹ Unlike the Illinois statute, the Florida statute does not require bad faith or unreasonableness. The Fifth Circuit Court of Appeals regarded this statute as appropriate authority for allowing fees in the federal interpleader case of *Perkins State Bank v. Connolly*.¹²⁰ The circuit court found, however, that the claimant could not meet the Florida statute's strict standards and therefore did not permit any fee recovery.

Both the Illinois and Florida provisions are manifestations of state procedural law.¹²¹ They apply to all civil cases and are triggered

119. The Florida statute provides: "the court shall award a reasonable attorney's fee to be paid to the prevailing party in . . . any civil action in which the court finds that there was a complete absence of a justiciable issue of other law or fact raised . . . by the losing party." FLA. STAT. ANN. § 57.105 (West 1987). A fee-shifting statute which only applies to a certain claim would be different. See *id.* § 542.22, a similar statute for antitrust claims which was used in the diversity case, *Norton Tire Co. v. Tire Kingdom Co.*, 116 F.R.D. 236 (S.D. Fla. 1987). See also *supra* note 98.

120. 632 F.2d 1306 (5th Cir. 1980). The court in *Perkins* misconstrued footnote 31 in *Alyeska* in two ways. It interpreted footnote 31 to exclude application of the federal bad faith exception. *Id.* at 1310. See also *supra* note 118. It also construed footnote 31 as requiring the effectuation of all state attorney's fee laws regardless of the underlying public policy. *Perkins*, 632 F.2d at 1310-11.

The *Perkins* court also analyzed the applicability of footnote 31 to interpleader cases brought under 28 U.S.C. § 1335 (1982) as distinguished from ordinary diversity cases brought under *id.* § 1332. As articulated in *Perkins*, statutory interpleader and general diversity jurisdiction differ in that the former often seeks to advance an interest which is not implicated in the latter: the protection of a bystander stakeholder, who holds funds claimed by two or more adverse parties, from multiple liability. *Perkins*, 632 F.2d at 1311. Due to this federal interest, state laws which deny uninterested stakeholders recovery of counsel's fees interfere with the purpose of § 1335 and therefore federal courts are not obligated to give them effect. *Id.* On the other hand, there is no federal interest in granting attorney's fees to the adverse claimants in an interpleader action in an amount different from what the claimants would have recovered in state court, and this includes the interpleading party who contests the ownership of the fund or disputes the amount of his liability (i.e., an action in the nature of interpleader), thereby becoming an adverse party himself. *Id.* But see *Aetna Life Ins. Co. v. Johnson*, 206 F. Supp. 63, 66 (N.D. Ill. 1962) (stakeholder usually not entitled to fees unless fees are available in state court because no federal question is present in interpleader action).

In addition to statutory interpleader actions involving disinterested or bystander stakeholders, another situation may arise in which a diversity case is not ordinary for purposes of footnote 31. This can occur when federal jurisdiction is invoked on the ground of diversity, but could have been based on a federal question. In such a case, the *Erie* doctrine policies regarding uniformity and forum shopping, which mandate the application of state substantive law in ordinary diversity cases, should not require application of state substantive law. See *Kalmbach, Inc. v. Insurance Co.*, 422 F. Supp. 44, 45 (D. Alaska 1976) (declining to apply state law governing attorney's fees in diversity case which could have been based on admiralty and maritime jurisdiction).

On the other hand, there is one type of claim which may not be based on diversity jurisdiction at all, but to which footnote 31 should apply. This claim involves a federal court's pendent or ancillary jurisdiction. See *supra* note 110.

121. In a separation of powers setting, however, the Florida Supreme Court has labeled FLA.

only when litigants fail miserably in preparing or prosecuting their claims. Their procedural nature is demonstrated by rule 11 of the Federal Rules of Civil Procedure,¹²² which was significantly altered in 1983 to deter attorney and party misconduct in the presentation of papers during civil litigation.

In addition to applying erroneously state statutes on procedure, federal courts hearing state law claims also have mistakenly employed state rules of civil procedure relating to attorney's fees. For example, the United States District Court for the District of Maryland, citing footnote 31, applied Maryland Rule of Procedure 1-341¹²³ (Maryland

STAT. ANN. § 57.105 (West 1987), quoted *supra* note 119, as substantive. In response to the argument that the statutory provision was a constitutional infringement upon the court's procedural rule making authority, the court stated, "To the contrary, an award of attorney's fees is a matter of substantive law properly underlying the aegis of the legislature." *Whitten v. Progressive Casualty Ins. Co.*, 410 So. 2d 501, 504 (Fla. 1982). The court cited a number of prior Florida Supreme Court decisions; each of these decisions, however, merely indicates that attorney's fees are not to be taxed as costs except where authorized by contract or statute. See, e.g., *Codomo v. Emanuel*, 91 So. 2d 653, 655 (Fla. 1956). Thus, the court's citation to these authorities begs the question of whether § 57.105, in particular, regulates procedure. In fact, the court in *Whitten* went on to describe the statute in a way suggesting its procedural character. It spoke of the legislative goals of discouraging baseless claims, stonewall defenses and sham appeals, and of avoiding the reckless waste of judicial resources. *Whitten*, 410 So. 2d at 505. As in the *Erie* setting, at least one court in a separation of powers setting seemingly labeled attorney's fees laws as substantive simply because a liability was created.

122. FED. R. CIV. P. 11 states in part:

Every pleading, motion, and other paper of a party represented by an attorney shall be signed by at least one attorney A party who is not represented by an attorney shall sign the party's pleading, motion, or other paper The signature of an attorney or party constitutes a certificate by the signer that the signer has read the pleading, motion, or other paper; that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. . . . If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

For the view that rule 11 may not be wholly procedural, see Burbank, *Sanctions in the Proposed Amendments to the Federal Rules of Civil Procedure: Some Questions of Power*, 11 HOFSTRA L. REV. 997 (1983).

123. Md. Rule 1-341 (quoted in *Brady v. Hartford Fire Ins. Co.*, 610 F. Supp. 735, 737 (D.C. Md. 1985)) provides:

In any civil action, if the court finds that the conduct of any party in maintaining or defending any proceeding was in bad faith or without substantial justification the court may require the offending party or the attorney advising the conduct or both of them to pay to

Rule or rule 1-341) in *Brady v. Hartford Fire Insurance Co.*¹²⁴ That rule granted courts discretion to assess costs and expenses, including payment of attorney's fees, against a party or a party's attorney who litigates in bad faith or without substantial justification. Maryland Rule of Procedure 1-341 superseded rule 604(b),¹²⁵ amending the latter by allowing a court to assess fees against a party's attorney as well as the party. Although the district court was aware that the purpose of Maryland Rule 1-341 was procedural, the court, sitting in diversity, retroactively applied the new Maryland provision in assessing fees against the plaintiff's attorney.¹²⁶ Plaintiff argued that application of the new rule was a substantive matter since the rule created "a new liability on the part of an attorney,"¹²⁷ and that substantive law should not be applied retroactively. The court held that retroactive application of the new Maryland Rule was proper because the question of who must pay attorney's fees was a question of procedure. Specifically, the court stated:

When a court imposes a rule which is designed to control the conduct of the litigation and the counsel appearing before the court, it is the opinion of this court that such a matter is procedural Thus, even assuming that imposition of attorney's fees against plaintiffs' counsel in this case is a retrospective application of Md. R. 1-341, that rule neither creates a new substantive right in the defendant nor deprives plaintiffs' attorney of a right which existed previously. It affects matters governing this court's power over counsel in a procedural way.¹²⁸

The *Brady* court's decision is troubling. Although the court held that retroactivity was not barred because rule 1-341 was procedural, the court apparently also deemed the rule substantive for *Erie* purposes as

the adverse party the costs of the proceeding and the reasonable expenses, including reasonable attorney's fees, incurred by the adverse party in opposing it.

124. 610 F. Supp. 735 (D. Md. 1985). See also *Pan Am. World Airways, Inc. v. Ramos*, 357 F.2d 341, 342 (1st Cir. 1966) (applying P.R. R. Civ. P. 44.4(D) which provides: "Where a party has been obstinate, the court shall in its judgment impose on such person the payment of a sum for attorney's fees.").

125. Maryland Rule of Procedure 604(b) (superseded by Md. R.P. 1-341) stated:

In an action or part of an action, if the court finds that any proceeding was had (1) in bad faith, (2) without substantial justification, or (3) for purposes of delay the court shall require the moving party to pay to the adverse party the amount of the costs thereof and the reasonable expenses incurred by the adverse party in opposing such proceeding, including reasonable attorney's fees.

Brady, 610 F. Supp. at 737 n.2 (quoting Md. R.P. 604(b)).

126. The case was filed in 1979, went to trial in 1982, and argument on appeal was made in April of 1984. Maryland Rule 1-341 went into effect on July 1, 1984.

127. *Brady*, 610 F. Supp. at 744.

128. *Id.*

it applied the rule to the case. Consequently, the court held that the rule was procedural for one purpose and substantive for another. While this characterization is not necessarily inconsistent, as seen in cases like *City of Carter Lake v. Aetna Casualty & Surety Co.*¹²⁹ described earlier, the court in *Brady* failed to explain why the two characterizations were appropriate. Moreover, the court did not analyze any policy considerations. The court's application of the state rule effectively foreclosed federal courts from employing federal procedural laws.

In applying footnote 31, some federal courts then are not examining the state policies underlying the various state fee-shifting provisions. As the foregoing cases illustrate, this failure has resulted in some federal courts in an *Erie* setting employing state, rather than federal, procedural laws on the assessment of attorney's fees.

In addition, footnote 31 has also caused misapplications of law outside the *Erie* context. For example, in a setting involving a choice between competing state laws, some courts have interpreted footnote 31 as suggesting that the forum state must always apply another state's fee-shifting law when the relevant cause of action originates within that other state. In *United California Bank v. THC Financial Corp.*,¹³⁰ the Ninth Circuit Court of Appeals ruled that a Hawaiian state court would follow footnote 31, and apply the California law on attorney's fees in a case involving a claim under California law.¹³¹ In assuming all attorney's fees laws to be substantive, the court failed to undertake any analysis of the substance/procedure dichotomy. In a similar choice of state law setting, a federal district court, in *Whiteside v. New Castle Mutual Insurance Co.*,¹³² assumed that the forum state would deem all laws on attorney's fees to be procedural. The district court reached this conclusion even though it had earlier cited footnote 31.¹³³ In both cases, as in some diversity cases, lower courts neglected to undertake a substance/procedure analysis.

129. 604 F.2d 1052 (8th Cir. 1979). See *supra* notes 31-37.

130. 557 F.2d 1351 (9th Cir. 1977).

131. *Id.* at 1361.

132. 595 F. Supp. 1096 (D. Del. 1984).

133. *Id.* at 1100. In ruling that fee awards are procedural in a state choice of law setting, the court relied upon *Chester v. Assiniboia Corp.*, 355 A.2d 880, 882 (Del. 1976) (applying Delaware statute granting fees against insurers who lose when sued upon any policy involving property, even though case may not have been based on claim under Delaware law). That application seems questionable under cases like *Sioux County, Neb. v. National Sur. Co.*, 276 U.S. 238 (1928), though the *Erie* and choice of law settings do occasionally differ. See *supra* notes 45-55 and accompanying text. The application of Delaware law was supported by the fact that the insurer was a Delaware resident.

Failures to distinguish substance and procedure are also found outside the *Erie* and choice of state law settings. For example, in *Endress v. Brookdale Community College*,¹³⁴ a state court hearing a federal civil rights claim assumed that all state laws on attorney's fees could be applied in the absence of any federal statutory law.¹³⁵ Thus, the court incorrectly assumed that state substantive, as well as state procedural, laws on fees might be available.¹³⁶

In choosing among fee-shifting laws, courts often fail to undertake a substance/procedure analysis. This failure is frequently caused by a misunderstanding of the Supreme Court's declarations in footnote 31 in *Alyeska*. To inquire further into the misreading of footnote 31, this Article will explore a phrase used in the footnote "substantial policy of the state,"¹³⁷ in more detail. This exploration will be centered around the major sources cited in footnote 31 and will further demonstrate the miscomprehension of Supreme Court precedent.

D. Examining the Sources Used in Footnote 31

In footnote 31, the Supreme Court in *Alyeska* primarily relied on three sources to support its assertion that, in a diversity case, federal courts should usually follow state fee-shifting laws. Those sources include the following: the Supreme Court's decision in *Hanna v. Plumer*;¹³⁸ Professor James W. Moore's treatise on federal practice;¹³⁹ and Stuart Speiser's treatise on attorney's fees.¹⁴⁰ A close examination of these sources reveals that the Supreme Court only intended for federal courts to employ state substantive fee-shifting laws in an *Erie* setting.

1. *Hanna v. Plumer*

In footnote 31, the *Alyeska* Court stated that the *Erie* principle was consistent with its prior holding in *Sioux County, Nebraska v. National Surety Co.*,¹⁴¹ that a federal court must enforce the state stat-

134. 144 N.J. Super. 109, 364 A.2d 1080 (1976).

135. *Endress*, 364 A.2d at 1101.

136. In rejecting possible application of cases on the federal equitable authority to award fees, the state court failed to differentiate between cases involving federal substantive and federal procedural law policies. *Id.* at 1100-01. On the federal equitable authority to award fees, see *supra* note 106.

137. *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975).

138. 380 U.S. 460 (1965). See *infra* notes 141-99.

139. 6 J. MOORE, *FEDERAL PRACTICE* (2d ed. 1974). See *infra* notes 200-36.

140. 1 S. SPEISER, *ATTORNEYS' FEES* (1973). See *infra* notes 237-73.

141. 276 U.S. 238 (1928).

utory right of an insured to attorney's fees.¹⁴² In support of this statement the Court cited a portion of its 1965 decision in *Hanna v. Plumer*.¹⁴³ This part of the *Hanna* decision held that choices between state law and federal law in diversity cases should be made by reference to the twin policies of *Erie Railroad v. Tompkins*:¹⁴⁴ "discouragement of forum-shopping and avoidance of inequitable administration of the laws."¹⁴⁵ The Court further remarked in *Hanna* that the importance of a state law to a state was a relevant factor in determining the applicability of the state law in federal court. Essential to the question of the law's importance is the question posed in *Hanna*, "important for what purpose?"¹⁴⁶

The failure by federal courts hearing state law claims to give effect to state procedural fee-shifting provisions would not thwart the twin aims of *Erie*. Generally, state procedural fee-shifting provisions apply to litigants in general and are not designed to favor particular causes or classes of litigants. Instead, the primary purpose of these state procedural fee-shifting laws is the minimization of either frivolous litigation or unreasonable litigation conduct.¹⁴⁷ A party would not be likely to choose a federal forum to escape such state laws. Parties do not generally contemplate that they or others will act in a frivolous or unreasonable manner. Furthermore, in light of the sanctions available under rule 11,¹⁴⁸ coupled with section 1927¹⁴⁹ and the inherent authority of federal courts to impose sanctions for vexatious conduct,¹⁵⁰ federal courts would not provide a haven for those seeking to avoid the consequences of state procedural fee-shifting laws. Consequently, under *Hanna*, some state fee-shifting laws can be viewed as promoting better practices before the state courts; their absence from federal courts in diversity cases would not undermine any important

142. *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975).

143. 380 U.S. 460 (1965).

144. 304 U.S. 64 (1938).

145. *Hanna*, 380 U.S. at 467-68.

146. *Id.* at 468 n.9.

147. See generally Leubsdorf, *supra* note 4. Some state procedural fee-shifting laws are, however, geared to particular causes and litigants, but nevertheless seek to deter unwarranted litigation conduct. These laws often are based on findings that the particular causes and litigants are especially susceptible to litigation misconduct. See, e.g., ILL. REV. STAT., ch. 110, §§ 2-611.1, 2-622 (Smith-Hurd Supp. 1987) (medical malpractice cases). See also *supra* note 98. But see Parness, *Frivolous Pleadings in Illinois: Observations on the 1985 Medical Malpractice Reforms*, 74 ILL. B.J. 238, 239 (1986) (questioning factual findings about medical malpractice claims in Illinois).

148. FED. R. CIV. P. 11, quoted *supra* note 122.

149. 28 U.S.C. § 1927 (1982), quoted *supra* note 118.

150. See *supra* note 106.

purpose, particularly since federal courts can employ federal fee-shifting laws that promote better federal court practices.

On the other hand, differences in state and federal fee-shifting provisions which are unrelated to litigation conduct may prompt a party to favor a federal forum. Some state fee-shifting provisions tend to benefit a specific class of litigants and contain no requirement that the opposing party act unreasonably or otherwise misbehave during litigation. The provision in *Sioux County, Nebraska v. National Surety Co.*¹⁵¹ is such a state law. There, the Nebraska statute required courts to make insurance companies pay the attorney's fees of an insured forced to bring suit to recover its insurance. Fee recovery was not available to the insurance company in the event it successfully defended a suit.¹⁵² Therefore, the statute was pro-plaintiff. More importantly, the statute did not contain a requirement that the insurance company act unreasonably during litigation. Thus, the statute favored one party over the other. Since there is no comparable federal law concerning an insured's rights, an insurer otherwise subject to the Nebraska statute might prefer to litigate in a federal court. Consequently, to promote the substantive policy of Nebraska dealing with the relationships between insureds and their insurers prior to any litigation, and to assure the equal treatment of all insureds governed by Nebraska law, federal courts had to apply this Nebraska statute. As a result, the Supreme Court's decision to enforce the Nebraska statute in *Sioux County* is consistent with the policies of *Erie* and *Hanna*, and does not necessarily suggest that application of all state fee-shifting provisions is compelled in an *Erie* setting. Indeed, a recent Supreme Court decision which occurred after *Alyeska* and *Hanna* suggests otherwise.

In the diversity case of *Burlington Northern Railroad v. Woods*,¹⁵³ the Supreme Court considered the applicability of an Alabama statute¹⁵⁴ which required a state appellate court, upon affirming a monetary judgment, to assess a penalty equal to ten percent of the judgment against an appellant who had executed a bond in order to stay the judgment.¹⁵⁵ The purposes of the statute were to penalize defendants who brought appeals that were frivolous or initiated for

151. 276 U.S. 238, 242 n.2 (1928) (citing NEB. COMP. STAT. § 7811 (1922)). See also *supra* text accompanying notes 45-49.

152. See *Sioux County*, 276 U.S. at 242 n.2.

153. 107 S. Ct. 967 (1987).

154. ALA. CODE § 12-22-72 (1986).

155. *Burlington*, 107 S.Ct. at 969. The Alabama statute provides in part:

the purpose of delay,¹⁵⁶ as well as to compensate prevailing complainants for the additional burden of defending valid judgments.¹⁵⁷ The Court also considered Federal Rule of Appellate Procedure 38¹⁵⁸ (rule 38) which granted federal appellate courts the discretion to award an appellee damages and costs when the court found that the appeal was frivolous.¹⁵⁹ The objectives of rule 38 were to afford justice to the appellee through compensation and to punish the appellant.¹⁶⁰

The Supreme Court, in *Burlington*, perceived a conflict between the mandatory state statute and the discretionary federal appellate rule.¹⁶¹ Writing for a unanimous panel, Justice Marshall found the guidelines for choosing between conflicting federal and state laws in *Hanna v. Plumer*.¹⁶² The guidelines necessitated a determination of whether the federal rule was of such breadth that it directly collided with the state law, or whether in the absence of a clash, the federal rule so controlled the issue that it precluded any operation of state law.¹⁶³ If there was an affirmative answer to either question, then a federal court had to apply the federal rule as long as it was valid.¹⁶⁴

Of course, a court can only apply a valid federal rule. The test of a federal rule's validity lies within the federal Constitution. Specifically, Article III,¹⁶⁵ supplemented by the Necessary and Proper Clause of Article I,¹⁶⁶ grants Congress the authority to ordain and establish the federal court system. Implicit in this grant of authority is the congressional power to enact rules of procedure governing liti-

When a judgment or decree is entered or rendered for money, whether debt or damages, and the same has been stayed on appeal by the execution of bond, with surety, if the appellate court affirms the judgment of the court below, it must also enter judgment against all or any obligors on the bond for the amount of the affirmed judgment, 10 percent damages thereon and the costs of the appellate court

ALA. CODE § 12-22-72 (1986).

156. *Burlington*, 107 S.Ct. at 969 (citing *Montgomery Light & Water Power Co. v. Thombs*, 204 Ala. 678, 87 So. 205, 211 (1920)).

157. *Id.* (citing *City of Birmingham v. Bowen*, 254 Ala. 41, 47 So. 2d 174, 179-80 (1950)).

158. FED. R. APP. P. 38 provides: "If a court of appeals shall determine that an appeal is frivolous, it may award just damages and single or double costs to the appellee."

159. *Burlington*, 107 S. Ct. at 969.

160. *Id.* (citing FED. R. APP. P. 38 advisory committee's notes).

161. *Id.* at 970.

162. 380 U.S. 460 (1965).

163. *Burlington*, 107 S. Ct. at 969 (citing *Walker v. Armco Steel Corp.*, 446 U.S. 740, 749-50 & 750 n.9 (1980); *Hanna*, 380 U.S. at 471-72).

164. *Id.* at 969-70 (citing *Hanna*, 380 U.S. at 471-74).

165. U.S. CONST. art. III, § 1.

166. *Id.* art. I, § 8, cl. 18.

gation in any federal court.¹⁶⁷ Congress can delegate this power, and it has done so, through the Rules Enabling Act.¹⁶⁸ A test of a federal rule's validity may include an inquiry into whether an exercise of the rulemaking power is constitutional.¹⁶⁹ Rules that are unquestionably procedural are necessarily constitutional.¹⁷⁰ In addition, rules regulating matters that fall within the gray area between substance and procedure and thus can reasonably be classified as either, also meet the test of constitutionality.¹⁷¹ Although the Rules Enabling Act further requires that a court-made rule not "abridge, enlarge or modify any substantive right,"¹⁷² rules that incidentally affect litigants' substantive rights do not violate this requirement or the Constitution.¹⁷³

In *Burlington*, the Supreme Court noted that rule 38 gave federal appellate courts the discretion to assess "just damages" as a means of punishing those responsible for frivolous appeals and of compensating the appellees for the expense and delay resulting from defending the appealed judgment.¹⁷⁴ The Court found that this authority to exercise discretion clashed with the mandatory character of the Alabama statute.¹⁷⁵ Furthermore, the Court determined that the objectives of rule 38 were "sufficiently coextensive" with the objectives of the state statute and "that the Rule occupie[d] the statute's field of operation so as to preclude its application in federal diversity cases."¹⁷⁶ In addition to rule 38, the Court observed that another federal rule also occupied the Alabama statute's "field of operation."¹⁷⁷ That rule was Federal

167. See *Burlington*, 107 S. Ct. at 969 n.3.

168. 28 U.S.C. § 2072 (1982) provides in part:

The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions

. . . .

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury at common law and as declared by the Seventh Amendment to the Constitution.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. . . .

169. *Burlington*, 107 S. Ct. at 970.

170. *Id.*

171. *Id.*

172. 28 U.S.C. § 2072 (1982).

173. *Burlington*, 107 S. Ct. at 970 (citing *Hanna*, 380 U.S. at 464-65).

174. *Id.*

175. *Id.*

176. *Id.* at 970-71.

177. *Id.* at 971.

Rule of Appellate Procedure 37¹⁷⁸ (rule 37) and it provided post-judgment interest for an appellee who successfully defended a judgment on appeal. This second rule compensated the appellee for his inability to use the judgment proceeds during the period the judgment was stayed pending appeal.¹⁷⁹ Consequently, the Court held that rule 37 was also coextensive with the compensatory purpose of the Alabama statute.¹⁸⁰

Having discerned a conflict between federal procedural law and the state statute on assessments against some unsuccessful appellants, the *Burlington* Court then examined the validity of rule 38. The Court deemed the rule constitutionally valid because the matters which it regulated could "reasonably be classified as procedural."¹⁸¹ In addition, the Court found that the rule was within the ambit of rulemaking authority granted by the Rules Enabling Act because its discretionary procedure did not impair any litigant's substantive rights, but only affected the process of enforcing those rights.¹⁸² Given the validity of rule 38, the Court concluded that the Alabama statute mandating a ten percent assessment against an unsuccessful appellant had no application in an *Erie* setting.¹⁸³

The relationship between rule 38 and the Alabama statute in *Burlington* is similar to the relationship between certain federal rules on fee-shifting and comparable state laws and rules on fee-shifting. For example, rule 11 allows shifting of attorney's fees in situations in which a federal court finds that litigation papers are unreasonable, unsupportable or otherwise improper.¹⁸⁴ *Burlington*, whose holding

178. FED. R. APP. P. 37 provides:

Unless otherwise provided by law, if a judgment for money in a civil case is affirmed, whatever interest is allowed by law shall be payable from the date the judgment was entered in the district court. If a judgment is modified or reversed with a direction that a judgment for money be entered in the district court, the mandate shall contain instructions with respect to allowance of interest.

179. *Burlington*, 107 S. Ct. at 971 n.5.

180. *Id.* at 971.

181. *Id.*

182. *Id.*

183. *Id.*

184. See FED. R. CIV. P. 11, quoted *supra* note 122. Although many states have adopted rule 11 into their codes or rules of conduct, see *supra* note 3, a significant number of states retain more restrictions on judicial power to sanction those responsible for groundless papers than exist in current rule 11 (many continuing with the more limited power under former Fed. R. Civ. P. 11). Compare, e.g., *Border City Sav. & Loan Ass'n v. Moan*, 15 Ohio St. 3d 65, 472 N.E.2d 350 (1984); *Daily Gazette Co. v. Canady*, 332 S.E.2d 262 (W. Va. 1985); OKLA. STAT. ANN. tit. 12, § 2011 (West Supp. 1987), S.C. R. Civ. P. 11.

strongly suggests that not all state fee-shifting provisions are applicable in federal courts, guides the application of the *Hanna* test for resolving conflicts between rule 11 and different state laws.

Although rule 11 requires district courts to sanction violations of the signature requirement, like rule 38, it provides that the type of sanction imposed is left to judicial discretion.¹⁸⁵ A state procedural law which mandates an assessment of attorney's fees or some other remedy as the sanction state courts must impose for violations of the signature requirement may collide with a federal court's discretion to impose an appropriate sanction. In addition, the breadth of rule 11, which establishes standards for all litigation papers and recognizes judicial authority to sanction violations of these standards, may control the issue of sanctioning this form of litigation misconduct, leaving no room for the operation of state laws. Finally, perhaps fee-shifting laws, like rule 11, are not meant to have application outside the judicial system whose government created the laws. This is because these laws are typically geared to deterrence of litigation misconduct in certain courts and not to compensation, though compensation is often a means of promoting deterrence.

Regarding the control of questions relating to litigation papers in trial courts, rule 11 is at least as broad as the federal rules in *Burlington* governing appeals. In *Burlington*, the Court found that rule 38 had the dual purpose of penalizing appellants pursuing frivolous appeals and compensating appellees for resulting injuries.¹⁸⁶ Because the purposes of rule 38, together with the compensatory goals of rule 37,¹⁸⁷ were sufficiently coextensive with the purposes of the Alabama statute, the Court held that the federal rules precluded application of the state law in diversity cases.¹⁸⁸ An examination of the purposes of rule 11 reveals that the rule is similarly coextensive with state procedural fee-shifting laws dealing with litigation papers. Like the punitive objective of rule 38, one purpose of rule 11 is to encourage the "detection and punishment" of violations of the rule's signature requirement.¹⁸⁹ Also, like the compensatory purposes of rules 38 and 37, an objective of rule 11 is "to award expenses, including attorney's

185. *Burlington*, 107 S. Ct. at 971.

186. *Id.* at 970-71.

187. FED. R. APP. P. 37, quoted *supra* note 178.

188. *Burlington*, 107 S. Ct. at 970-71.

189. Preliminary Draft of Proposed Amendments to the Federal Rules of Civil Procedure, 90 F.R.D. 451, 461 (1981) (FED. R. CIV. P. 7(b)(3) advisory committee's note) [hereinafter Preliminary Draft], recognized in 90 F.R.D. at 465 (FED. R. CIV. P. 11 advisory committee's note).

fees, to a litigant whose opponent acts in bad faith in instituting or conducting litigation.”¹⁹⁰ Finally, rule 11 emphasizes “a deterrent orientation in dealing with improper pleading.”¹⁹¹ In light of these multiple objectives, rule 11 seemingly occupies a field of operation so that state fee-shifting provisions primarily designed to deal with improper papers during litigation have no place in federal court practice.

In addition, like rule 38, rule 11 “regulates matters which can reasonably be classified as procedural,”¹⁹² and thus rule 11 is within the limits of the Rules Enabling Act. This is because the recognition of a discretionary authority regarding the type of sanction necessary for any rule 11 violation “affects only the process of enforcing rights and not the rights themselves.”¹⁹³ Although the application of rule 11 to the preclusion of a state fee-shifting provision in an *Erie* setting may “incidentally affect litigants’ substantive rights,”¹⁹⁴ the constitutional or statutory validity of the rule is clear in light of its essential role in promoting the integrity of the judicial process.

Consequently, the discretionary authority under rule 11 to shift attorney’s fees in order to punish, compensate, and deter certain forms of litigation misconduct suggests that the rule occupies the field of operation of state fee-shifting provisions geared toward regulating comparable litigation conduct. Coupled with the recognition of the rule’s validity, this leads to the conclusion that, under *Hanna v. Plumer*,¹⁹⁵ some state fee-shifting provisions are not applicable in an *Erie* setting. Like the decisions in *Sioux County, Nebraska v. National Surety Co.*¹⁹⁶ and *Burlington, Hanna* contemplates that *Erie Railroad v. Tompkins*¹⁹⁷ requires federal courts hearing state law claims to utilize simultaneously federal procedural fee-shifting laws and state substantive fee-shifting laws. Such utilization is similar to the determination in *Marek v. Chesny*¹⁹⁸ that federal courts can, and must, simultaneously employ federal procedural and federal substantive fee-shifting laws in a federal court action involving federal law

190. 90 F.D.R. at 463 (FED. R. CIV. P. 11 advisory committee’s note).

191. *Id.* at 465 (FED. R. CIV. P. 11 advisory committee’s note).

192. *Burlington*, 107 S. Ct. at 971.

193. *Id.*

194. *Id.* at 970. *But see* Burbank, *supra* note 122 (suggesting rule 11 may not be wholly procedural).

195. 380 U.S. 460 (1965).

196. 276 U.S. 238 (1928).

197. 304 U.S. 64 (1938).

198. 473 U.S. 1 (1985).

claims.¹⁹⁹ Accordingly, federal courts cannot interpret the reference to *Hanna* in footnote 31 as mandating the enforcement of all state fee-shifting laws in an *Erie* setting.

2. *Moore's Federal Practice*

The next authority that the Supreme Court relied on in footnote 31 was a treatise by Professor James W. Moore.²⁰⁰ In his treatise, Moore stated that in "an ordinary diversity case where the state law does not run counter to a valid federal statute or rule of court . . . state law denying the right to attorney's fees or giving a right thereto, which reflects a substantial policy of the state, should be followed."²⁰¹ Although Moore did not define "substantial policy of the state," a close examination of his analysis reveals that Moore used this term to denote only state fee-shifting laws that can be deemed substantive under *Erie* and its progeny. Moore reached his conclusion by analyzing cases in which federal courts had applied state fee-shifting laws. First, he examined cases in which federal courts enforced state laws that denied fee awards. Then, he examined cases in which federal courts enforced state laws that allowed fee awards. All of the cases that Professor Moore analyzed dealt with state laws that were substantive in the *Erie* sense. Consequently, Moore must have used the phrase "substantial policy of the state" to denote state substantive fee-shifting laws in the *Erie* context as this Article will demonstrate in the next two subsections.

a. *State Laws Denying Fees*

Moore first cited *Mercantile-Commerce Bank & Trust Co. v. Southeast Arkansas Levee District*²⁰² to support the proposition that courts in an *Erie* setting should enforce state laws that deny attorney's fees awards.²⁰³ In *Mercantile-Commerce Bank*, a federal circuit court reviewed an Arkansas law that voided provisions in promissory notes which stipulated attorney's fees would be paid to the payee in the event of a lawsuit. The court applied the state law and thus disal-

199. See *supra* notes 17-30 and accompanying text.

200. See 6 J. MOORE, *supra* note 139.

201. *Id.* ¶ 54.77[2], at 1712-13 (cited in *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975)).

202. 106 F.2d 966 (8th Cir. 1939).

203. 6 J. MOORE, *supra* note 139, ¶ 54.77[2], at 1712 n.23 (2d ed. 1981) (this Article assumes that the supporting cases in the 1974 edition of *Federal Practice* cited by the Supreme Court and the 1981 edition of *Federal Practice* are comparable).

lowed attorney's fees for the foreclosure of a mortgage. In its analysis, the court found the "substantial policy of the state" underlying the Arkansas law in *Boozer v. Anderson*.²⁰⁴ In *Boozer*, the Supreme Court of Arkansas viewed a similar stipulation in a promissory note as an agreement for a penalty. The *Boozer* court noted that courts of equity do not favor penalties and concluded that whenever a court can accurately measure an injury that resulted from a breach of contract, "the parties will not be allowed to stipulate for a greater amount."²⁰⁵ Specifically, it held, "[W]hen a debtor pays the debt, with interest for its detention and costs of suit, he ought not be mulcted in a further sum."²⁰⁶ Thus, substantive contract law embodied the "substantial policy of the state."²⁰⁷ The purpose of the Arkansas law was to confine a promisor's liability for breach of contract to certain forms of compensation.

However, while Arkansas contract law precluded fees, other Arkansas substantive law decisions allowed them. The federal court, in *Mercantile-Commerce Bank*, found that certain Arkansas Supreme Court decisions allowed compensation to trustees and their attorneys for performance of the trustee's essential duties—devotion "to questions affecting the substantial preservation of the trust estate and the beneficial interest of all concerned."²⁰⁸ Deciding that the purpose of the law was to allocate fairly the cost of preserving a trust among those who benefit from such preservation, the court followed these decisions and charged against the trust the counsel fees incurred in the protection of the trust.

The next case noted by Moore which involved a state law denying fees was *Trust Co. v. National Surety Corp.*²⁰⁹ In that case, a federal circuit court followed Illinois law, declared in *Patterson v. Northern Trust Co.*,²¹⁰ which stated that costs could "be recovered only in cases where there is statutory authority therefor."²¹¹ Since the plaintiffs in *Trust Co.* could not bring themselves within a statutory

204. 42 Ark. 167 (1883) (cited in *Mercantile-Commerce Bank*, 106 F.2d at 970).

205. *Id.* at 169.

206. *Id.*

207. *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975).

208. *Mercantile-Commerce Bank*, 106 F.2d at 972.

209. 177 F.2d 816 (7th Cir. 1949).

210. 286 Ill. 564, 122 N.E. 55 (1919).

211. *Trust Co.*, 177 F.2d at 819. The court said, "The rule is also well established that attorney fees and the ordinary expenses and burdens of litigation are not allowable to the successful party in the absence of a statute, or in the absence of some agreement or stipulation specially authorizing the allowance thereof" *Id.*

provision, the court denied attorney's fees.²¹²

Illinois law, in *Trust Co.*, reflected the American Rule that a litigant must pay his own attorney's fees in the absence of statutory authorization, court rule or contractual provision.²¹³ As applied, this rule contains substantive as well as procedural laws. A major purpose in some applications of the rule is to prevent a chilling effect upon those who otherwise would vindicate their rights through the court system.²¹⁴ However, the rule is often excepted, such as by section 1988,²¹⁵ in order to promote the enforcement of certain substantive rights. Another form of exception involves assessment of fees against litigants who act in bad faith or otherwise improperly during litigation, thereby causing a drain on the adjudicatory system as well as on their opponents. This form of exception usually is aimed at deterring procedural law misconduct regardless of the substantive rights involved. In *Trust Co.*, only the substantive law exceptions to the American Rule were implicated, as the court did not indicate any concern for litigation misconduct. Consequently, the federal court in *Trust Co.* properly applied the state substantive law.

Finally, as authority for the proposition that federal courts under *Erie* should apply state laws denying attorney's fees when such laws reflect a substantial state policy, Moore relied on *Republic of China v. Central Scientific Co.*²¹⁶ Interestingly, the court in that case heavily relied on an earlier edition of Moore's treatise and interpreted the treatise to indicate that a federal court must apply the substantive state policy on attorney's fees in an *Erie* setting.²¹⁷ In *Republic of China*, the district court looked to an Illinois law that prohibited attorney's fees from being assessed as costs, and concluded that it had to deny attorney's fees.²¹⁸ Hence, in discussing in his treatise state law which "reflects a substantial policy of the state,"²¹⁹ Moore cited a

212. *Id.* Similarly, the United States Court of Appeals for the Tenth Circuit followed a comparable state policy in the diversity case of *United Pac. Ins. Co. v. Northwestern Nat'l Ins. Co.*, 185 F.2d 443 (10th Cir. 1950). This case was also cited by Moore in his treatise section relied on by the Supreme Court in *Alyeska*. 6 J. MOORE, *supra* note 139, ¶ 54.77[2], at 1712 n.23 (2d ed. 1981). The circuit court in *United Pacific* reversed the district court's allowance of attorney's fees to an insured, observing that no Utah statute or contractual provision was applicable. *United Pacific*, 185 F.2d at 448.

213. See 1 S. SPEISER, *supra* note 140, § 12:3, at 463-64.

214. *Id.* § 12:3, at 467.

215. 42 U.S.C. § 1988 (1982) (discussed *supra* note 19).

216. 120 F. Supp. 924 (N.D. Ill. 1954).

217. *Id.* at 925 (citing 6 J. MOORE, *supra* note 139, at 1347, 1352 (2d ed. 1938)).

218. *Id.*

219. 6 J. MOORE, *supra* note 139, ¶ 54.77[2], at 1712-13 (2d ed. 1981).

case in which the court applied a state law that "discloses a 'substantive' policy"²²⁰ (in reliance on Moore's own earlier treatise). These cases all suggest, then, that in endorsing the application of state attorney's fee provisions in an *Erie* setting, Moore was referring to substantive laws which reflect significant state policy, as opposed to all state laws, substantive and procedural, which embody significant policies of the state.

b. State Laws Allowing Fees

In moving from an examination of state laws which deny recovery of attorney's fees to state laws which allow such recovery, Moore first cited *Sioux County, Nebraska v. National Surety Co.*²²¹ as an instance in which a federal court sitting in diversity applied a state statute allowing attorney's fees to the prevailing party.²²² As previously noted, the Nebraska statute in *Sioux County* was aimed at aiding those entitled to benefits under an insurance policy to vindicate their rights. To achieve this goal, the statute imposed a liability upon the recalcitrant insurer for payment of the insured's attorney's fees. This liability was an incident of the insurer's wrongful refusal to meet its contractual obligation prior to litigation and, consequently, the statute was substantive.²²³

In *Gandall v. Fidelity & Casualty Co.*,²²⁴ also cited by Moore,²²⁵ a

220. *Id.*

221. 276 U.S. 238 (1928).

222. 6 J. MOORE, *supra* note 139, ¶ 54.77[2], at 1713 n.24 (2d ed. 1981).

223. See *supra* notes 45-53 and accompanying text. Like the Nebraska statute in *Sioux County*, the Florida statute enforced by the United States Court of Appeals for the Fifth Circuit in *Phoenix Indem. Co. v. Anderson's Groves, Inc.*, 176 F.2d 246 (5th Cir. 1949) (cited in 6 J. MOORE, *supra* note 139, ¶ 54.77[2], at 1713 n.24 (2d ed. 1981)) provided for an allowance of attorney's fees to a beneficiary who successfully brings suit under an insurance policy. In *Phoenix*, an insurance company brought suit for a declaratory judgment against the insured. Dissenting in part, Judge Hutcheson stated that the majority, by allowing the insured to recover its attorney's fees, had misapplied the Florida statute. *Id.* at 248 (Hutcheson, J., concurring in part and dissenting in part). Judge Hutcheson drew a distinction between a situation where an insured brings suit against an insurer who wrongfully refuses to pay, and a situation in which the insurer simply seeks from the court a declaration and instructions as to what it should do. *Id.* at 249. Judge Hutcheson reasoned that Florida courts would not apply the statute in such circumstances since Florida courts view the law as retributive in nature and as "designed to compel insurers to abide by their contracts without . . . wrongful litigation." *Id.* Judge Hutcheson's conclusion can be harmonized with the view expressed by Judge Strum in *Orlando Candy Co. v. New Hampshire Fire Ins. Co.*, 51 F.2d 392 (S.D. Fla. 1931). See *supra* notes 51-53 and accompanying text. Since the liability imposed by the statute is an incident of the insurer's wrongful conduct outside of litigation, it may be that in the absence of wrongful conduct, no liability should exist.

224. 158 F. Supp. 879 (E.D. Wis. 1958).

225. See 6 J. MOORE, *supra* note 139, ¶ 54.77[2], at 1713 n.24 (2d ed. 1981).

federal district court sitting in diversity followed a Wisconsin statute which provided for the taxation of *guardian ad litem* fees as costs against an unsuccessful defendant.²²⁶ The district court quoted Moore's treatise and stated, " 'In an action involving a non-federal matter state law should . . . normally be followed where the state law reflects a "substantive" policy relative to non-conventional items of expense, such as attorney's fees.' " ²²⁷ Next, the *Gandall* district court quoted from the portion of Moore's treatise used in footnote 31 in *Alyeska* and said:

"But in an ordinary diversity case where the state law does not run counter to a valid federal statute or rule, and usually it will not, state law denying the right to attorney's fees or giving a right thereto, which reflects a *substantial policy of the state*, should be followed."²²⁸

The *Gandall* court concluded that the Wisconsin statute expressed a state policy which should have been followed regardless of whether the statute was typed substantive or procedural.²²⁹ Thus, the court in *Gandall* found that a necessary criteria for applying a state provision regarding the shifting of attorney's fees is that the provision must do more than regulate procedure—federal courts will follow state laws which are "the kind expressive of a substantive state policy."²³⁰

Finally,²³¹ Moore relied on *Reynolds v. Wade*²³² to support his

226. *Gandall*, 158 F. Supp. at 881.

227. *Id.* (emphasis added by court) (quoting 6 J. MOORE, *supra* note 139, ¶ 54.77, at 1346-47 (2d ed. 1938), now found in 6 J. MOORE, *supra* note 139, ¶ 54.77[1], at 1701-02 (2d ed. 1987)).

228. *Id.* (emphasis added by court) (quoting 6 J. MOORE, *supra* note 139, ¶ 54.77, at 1354-55 (2d ed. 1938), now found in 6 J. MOORE, *supra* note 139, ¶ 54.77[2], at 1712-13 (2d ed. 1987)).

229. *Id.* at 882 (citing *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 555 (1949)). For a discussion of *Cohen*, see *supra* notes 69-73 and accompanying text. The label attached to a statute by a state is not dispositive as to its characterization in an *Erie* setting because, for instance, the state may embody some of its substantive law for *Erie* purposes in what it calls its Code or Rules of Civil Procedure. Such an embodiment should not be troublesome unless substantive law is found in a procedural rule adopted by a body (such as a court) which is limited to promulgating procedural laws. See, e.g., 28 U.S.C. § 2072 (1982) (court's rules cannot enlarge or modify substantive rights). Compare *infra* note 235.

230. *Gandall*, 158 F. Supp. at 882. The district court, in *Gandall*, dispelled the defendant's argument that a federal court, even in a diversity case, was precluded from taxing any costs not mentioned in the federal statutes. The court cited *McDaniel v. Standard Accident Ins. Co.*, 221 F.2d 171 (7th Cir. 1955), in which the court in a diversity case applied Illinois law regarding attorney's fees. *Gandall*, 158 F. Supp. at 882. The Illinois statute applied in *McDaniel* permitted recovery of attorney's fees as a cost where the insurance company refused to pay the loss "vexatious[ly] and without reasonable cause." *McDaniel*, 221 F.2d at 173. The state law applied is founded upon a substantive state policy involving regulation of an insurance company's prelitigation activity, and its use by the federal court in *McDaniel* was correct.

231. Moore next cited two cases, *Empire State Ins. Co. v. Chafetz*, 302 F.2d 828 (5th Cir. 1962) and *Henlopen Hotel Corp. v. Aetna Ins. Co.*, 38 F.R.D. 155 (D. Del. 1965). 6 J. MOORE,

proposition that federal courts under *Erie* should apply state laws allowing attorney's fees when these laws reflect a substantial policy of the state.²³³ In *Reynolds*, a federal court, sitting in diversity, followed an Alaska statute which provided:

The measure and mode of compensation of attorneys shall be left to the agreement, expressed or implied, of the parties: but there may be allowed to the prevailing party in the judgment certain sums by way of indemnity for his attorney fees in maintaining the action or defense thereto, which allowances are termed costs.²³⁴

Although the allowance of attorney's fees is not directed toward a specific type of litigant such as an insured, and is not designed to aid the vindication of a specific right or cause of action, the underlying policy, to indemnify the prevailing party, can be viewed as substantive in an *Erie* setting. Unlike rule 11, whose primary goal is deterrence, the primary purpose of the Alaska statute is compensation.²³⁵ Even

supra note 139, ¶ 54.77[2], at 1713 n.24 (2d ed. 1981). In *Chafetsy* and *Henlopen*, federal courts applied state statutes mandating the allowance of attorney's fees to a beneficiary under an insurance contract where judgment is rendered against the insurer. These statutes clearly embody substantive state law and, as such, should be applied by a federal court sitting in diversity.

232. 140 F. Supp. 713 (D. Alaska 1956), *rev'd*, 249 F.2d 73 (9th Cir. 1957).

233. 6 J. MOORE, *supra* note 139, ¶ 54.77[2], at 1713 n.24 (2d ed. 1981).

234. *Reynolds*, 140 F. Supp. at 715 (quoting A.C.L.A. 1949 § 55-11-51).

235. A.C.L.A. 1949 § 55-11-51 has been repealed, and the area it covered is now contained in ALASKA CIV. R. 54(d), 82, promulgated pursuant to ALASKA STAT. § 09.60.010 (Supp. 1987):

The supreme court shall determine by rule or order the costs, if any that may be allowed a prevailing party in a civil action. Unless specifically authorized by statute or by agreement between the parties, attorney's fees may not be awarded to a party in a civil action for personal injury, death or property damage related to or arising out of fault, as defined in A.S. 09.17.900, unless the civil action is contested without trial or fully contested as determined by the court.

Because the policies underlying § 55-11-51 are now, in part, embodied in Alaska Civil Rule 82, the stated purpose of rule 82 is indicative of the purpose of the former statute applied in *Reynolds*. In *McDonough v. Lee*, 420 P.2d 459 (Alaska 1966), Justice Rabinowitz of the Supreme Court of Alaska stated:

The purpose of Civil Rule 82 in providing for the allowance of attorney's fees is to partially compensate a prevailing party for the costs to which he has been put in the litigation in which he was involved. The rule was not designed to be used capriciously or arbitrarily, or as a vehicle for accomplishing any purpose other than providing compensation where it is justified.

Id. at 465 (emphasis added) (quoting Preferred Gen. Agency v. Raffetto, 391 P.2d 951, 954 (Alaska 1964)). Thus, the major purpose of rule 82 seemingly is to provide some indemnification to the prevailing party, and not to punish a losing party for any litigation misconduct or to deter meritless litigation. Although the rule is labelled procedural and was promulgated by the Alaska Supreme Court, the attorney's fee provision embodies a substantive policy of compensation and therefore may properly be enforced by federal courts in an *Erie* setting. If any problem does arise, it is one of separation of powers in that substantive laws are not usually found within procedural rules. However, promulgation of rule 82 appears to be within the authority granted the state supreme court, as

though the compensation statute has a tendency to deter meritless litigation, this deterrence is ancillary to the statutory goal of compensating a prevailing party for the costs of litigation. The statute applies regardless of the litigation conduct of any party or lawyer, and consequently, courts view it as substantive.²³⁶

Accordingly, the sources cited by Moore in support of his propositions quoted by the Supreme Court in footnote 31 in *Alyeska*, are diversity cases in which the federal courts applied substantive state law on attorney's fees. Thus, his treatise lends no support to the proposition that the Supreme Court, in footnote 31, intended for federal courts hearing state law claims to apply all forms of state fee-shifting laws.

3. *Speiser's Attorneys' Fees*

Following the quote from Moore's *Federal Practice*, the Supreme Court in *Alyeska* in footnote 31 cited Stuart Speiser's treatise on attorney's fees.²³⁷ The section in the treatise mentioned by the Court begins:

In diversity actions, with the exception of the federal statute governing attorneys' docket fees, the federal courts, in the absence of countervailing equitable principles, apply state law with regard to the allowance or disallowance of attorneys' fees, whether the state law is (1) state statutory law governing the allowance or disallowance of attorneys' fees; (2) state statutory or nonstatutory law as to the validity or construction of contractual provisions for attorneys' fees; or (3) state nonstatutory law governing the allowance or disallowance of attorneys' fees in the absence of contract.²³⁸

the enabling statute, ALASKA STAT. § 09.60.010 (Supp. 1987), does not expressly limit the court's power to the promulgation of attorney's fees rules which are based on procedural law objectives. Compare ALASKA CIV. R. 82 with 28 U.S.C. § 2072 (1982) (Federal Rules of Civil Procedure promulgated by U.S. Supreme Court may not abridge, enlarge, or modify any substantive right).

236. By comparison, while Federal Rule 11 also provides compensation in the form of an award of attorney's fees, its primary purpose is deterrence of litigation misconduct. Preliminary Draft, *supra* note 189, 90 F.D.R. at 465 (FED. R. CIV. P. 11 advisory committee's note).

237. 2 S. SPEISER, *supra* note 140, §§ 14:3, 14:4, at 10-12 (cited in *Alyeska Pipeline Co. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975)).

238. *Id.* § 14:3, at 10 (footnotes omitted). Speiser cited a number of cases in which federal courts, in the absence of countervailing equitable principles, have followed state law on attorney's fees. See, e.g., *Hardware Dealers Mut. Fire Ins. Co. v. Smart*, 293 F.2d 558 (10th Cir. 1961) (attorney's fees awarded to insured pursuant to Kansas statute mandating such allowance in all actions where insured prevails on policy insuring against loss by fire, tornado, lightning or hail); *Stokes v. Reeves*, 245 F.2d 700 (9th Cir. 1957) (erroneously concluding that any state law claim for attorney's fees is to be treated as substantive for *Erie* purposes, but correctly applying Texas law allowing fees for claimants in actions for value of services rendered); *Crescent Lumber & Shingle Co. v.*

Although Speiser did not expressly distinguish between state substantive and state procedural laws on attorney's fees, he qualified his initial statement with the following sentence: "Thus state statutes allowing the recovery of attorneys' fees in *special classes of actions* have frequently been given effect in suits brought in federal courts."²³⁹ This statement indicates that federal courts do not apply all state fee-

Rotherum, 218 F.2d 638 (5th Cir. 1955) (applying Texas statute involved in *Stokes*); Lone Star Producing Co. v. Gulf Oil Corp., 208 F. Supp. 85 (E.D. Tex. 1962) (same), *rev'd*, 322 F.2d 28 (5th Cir. 1963); Foy v. Mutual Life Ins. Co., 127 F. Supp. 916 (N.D. Fla. 1955) (attorney's fees awarded to insured pursuant to Florida statute requiring that judgment in favor of insured against insurer include reasonable compensation to insured's attorney).

To illustrate an instance in which a federal court did not follow state law regarding attorney's fees because of the presence of "countervailing equitable principles," Speiser cited *Forest Laboratories, Inc. v. Formulations, Inc.*, 320 F. Supp. 211 (E.D. Wis. 1970) (federal court disregarded state law which followed American Rule and held that breach of confidence and improper use of plaintiff's trade secrets prior to litigation was sufficient to justify awarding plaintiff attorney's fees as part of damages under equitable principles), *aff'd in part and rev'd in part sub nom.* *Forest Laboratories, Inc. v. Pillsbury Co.*, 452 F.2d 621 (7th Cir. 1971). While *Forest* illustrates the general point made by Speiser, the court's decision was wrong, as the court in an *Erie* setting employed its equity power to create substantive federal law inappropriate under *Erie*. State law clearly should have governed the liabilities flowing from the prelitigation conduct giving rise to the civil action. A better illustration of a case in which federal courts utilized countervailing equitable principles is *Howard v. Christ-Craft Corp.*, 562 F. Supp. 932 (E.D. Tex. 1982) (application of federal procedural common law founded on a policy of minimizing bad faith litigation activities).

In reference to state nonstatutory laws governing the allowance of attorney's fees, Speiser cited *Craven v. Shoults*, 97 F.2d 299 (8th Cir. 1938), in which a federal court upheld an award of attorney's fees to a party who successfully defended the validity of a will. The *Craven* court examined the state policy underlying the state nonstatutory fee-shifting law and concluded that the law was based on a substantive policy of allowing the successful litigant's attorney's fees to be paid out of the estate so as to fairly spread the cost among those who have benefited, as well as on a policy of encouraging legatees to assert claims.

Speiser pointed to a few cases in which federal courts denied attorney's fees on the ground that the law of the state in which the federal court sat did not apply under the circumstances. See *Miller's Nat'l Ins. Co., Chicago, Ill. v. Wichita Flour Mills Co.*, 257 F.2d 93, 102 (10th Cir. 1958) (construing Kansas statute authorizing award of attorney's fees in cases which involve loss "by fire, tornado, lightning or hail" as inapplicable where explosion caused the loss, even though the policy insured against loss by fire); *Blum v. William Goldman Theatres, Inc.*, 164 F.2d 192, 198 (3d Cir. 1947) (adhering to general rule of Pennsylvania that each party is usually required to pay his own counsel fees, and noting that the purpose of the rule is that otherwise "clients would pay liberally out of the pockets of their adversaries." (quoting *Alexander v. Herr's Exr's*, 11 Pa. 537, 539 (1849))); *Fidelity & Casualty Co. v. Dorough*, 107 F. 389 (C.C.A. Tex. 1901) (holding that Texas statute requiring life or health insurance companies to pay attorney's fees of insured when company fails to pay following a loss did not apply to accident insurance companies because state statute should be strictly construed and was penal in character because it denied one class of suitors the right to contest its rights or liabilities under contract).

239. 2 S. SPEISER, *supra* note 140, § 14:3, at 10-11 (emphasis added). To support this qualifying statement, Speiser cited *Whitson v. Yaffe Iron & Metal Corp.*, 385 F.2d 168 (8th Cir. 1967), in which the court allowed attorney's fees in an enforcement proceeding pursuant to Arkansas contract law. Thus, the "special class of actions" in *Whitson* was a proceeding to enforce a contract, and the state law given effect by the federal court, contract law, was substantive, not procedural, under *Erie*.

shifting laws, and is consistent with the notion that federal courts should apply only substantive fee-shifting laws. In another section of his treatise, also cited by the Supreme Court in footnote 31,²⁴⁰ Speiser lists the kinds of state fee-shifting statutes federal courts have frequently applied; each one is based on a state law policy which is substantive under *Erie*.

In describing the types of state fee-shifting laws applied by federal courts, Speiser declared that the kind most frequently followed involves beneficiaries who seek to recover attorney's fees from insurance companies with whom they litigate.²⁴¹ *Fidelity Mutual Life Association v. Mettler*²⁴² illustrates the substantive character of this type of fee provision. In this case, the Supreme Court stated that in enacting a statute which provided that life and health insurance companies who defaulted in payment of their policies would be liable for reasonable attorney's fees, the Texas legislature evidently contemplated "the necessity of the prompt payment of the insurance money in very many cases in order to provide the means of living of which the beneficiaries had been deprived by the death of the insured."²⁴³ Clearly, the law transcends the regulation of court procedure since it is based on a policy of providing for the well-being of beneficiaries who have lost their means of support. The law discourages insurance companies from withholding payments on policies even if there may be some legitimate reason. Consequently, the law is substantive in an *Erie* setting.

A second type of fee statute noted by Speiser as applied by federal courts involves the rights of a county board of supervisors to recover counsel fees from a depository that delayed in paying county funds when lawfully demanded. In *National Surety Co. v. LeFlore County, Mississippi*,²⁴⁴ the circuit court applied a Mississippi statute,²⁴⁵ which compelled a depository who delayed in transferring county funds to pay the county its collection expenses, including attorney's fees, as well as to pay damages of one percent per month for the delay. The statute further provided that "the bond of any deposi-

240. *Alyeska Pipeline Co. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975).

241. 2 S. SPEISER, *supra* note 140, § 14:4, at 12.

242. 185 U.S. 308 (1902). *Mettler* was first in a string of cases cited in 2 S. SPEISER, *supra* note 140, § 14:4, at 12 n.39.

243. *Mettler*, 185 U.S. at 327.

244. 262 F. 325 (C.C. Miss. 1919), *cert. denied*, 253 U.S. 490 (1920). *National Surety* was the sole case cited in 2 S. SPEISER, *supra* note 140, § 14:4, at 12 n.41.

245. See MISS. CODE ANN. § 27-105-329 (1972) (current version).

tory shall be liable for said expenses and damages.”²⁴⁶ In considering the liability of the depository’s surety for the depository’s failure to account for county funds, the court held:

[T]he statute imposes damages by way of penalty for delay and counsel fees for collection primarily only upon the depository, and not upon the surety. The defaults punished by the statute are those of the depository alone by the very terms of the statute, and the damages and counsel fees are imposed upon the depository, and it alone.²⁴⁷

The court added, “The terms of the statute . . . enter into the contract between the county and the depository.”²⁴⁸ This reasoning is analogous to that found in Judge Strum’s opinion in *Orlando Candy Co. v. Hampshire Fire Insurance Co.*²⁴⁹ *Orlando* dealt with a statute that imposed liability for payment of an insured’s attorney’s fees upon a recalcitrant insurer. In *Orlando*, the court noted that the parties contracted, subject to the terms of the statute, and the statute thereby became a part of the contract.²⁵⁰ The court characterized liability imposed by the statute as “an incident to the insurer’s wrongful refusal to pay, not a mere procedural incident to entry of judgment.”²⁵¹ Likewise, in *National Surety*, the liability imposed by the Mississippi statute was an incident to the depository’s wrongful withholding of county funds.²⁵² The statute did not seek to regulate litigation conduct, but rather to impact upon the relationship between a county and a depository of county funds by imposing fees and penalties upon the depository for default in its obligations. Consequently, like the state statute in *Orlando*, the state statute in *National Surety* was substantive for *Erie* purposes.

Another type of state fee-shifting law recognized by Speiser, as applicable in federal courts, concerns an award of attorney’s fees in suits involving claims for services rendered or materials furnished. In both *Zweig v. Bethlehem Supply Co.*²⁵³ and *Crescent Lumber & Shingle Co. v. Rotherum*,²⁵⁴ a federal circuit court applied such a stat-

246. *Id.*

247. *National Surety*, 262 F. at 330.

248. *Id.*

249. 51 F.2d 392 (S.D. Fla. 1931). See *supra* notes 51-55.

250. *Orlando*, 51 F.2d at 393.

251. *Id.*

252. *National Surety*, 262 F.2d at 330.

253. 186 F.2d 20 (5th Cir. 1951) (cited in 2 S. SPEISER, *supra* note 140, § 14:4, at 12 n.42).

254. 218 F.2d 638 (5th Cir. 1955) (cited in 2 S. SPEISER, *supra* note 140, § 14:4, at 12 n.42).

ute.²⁵⁵ Neither case makes any reference to the policy rationale(s) underlying the law. However, the nature of this statute may be characterized as substantive under *Erie*, because the purpose relates to full compensation for a certain class of litigants regardless of their litigation activities.

Other types of state statutes employed by federal courts hearing state law claims which were noted by Speiser include those allowing attorney's fees in suits for violations of state securities laws. For example, in *Associated Manufacturers Corp. v. De Jong*,²⁵⁶ a federal circuit court upheld an attorney's fee award pursuant to an Iowa statute.²⁵⁷ The statute provided that a sale or contract for sale of securities made in violation of an Iowa Blue Sky law was voidable at the purchaser's election and that the seller was liable to the purchaser for the full amount paid, together with costs and reasonable attorney's fees. The *De Jong* court did not discuss the policy underlying the statute. However, the purpose of this type of statute must be to protect more fully the purchaser.²⁵⁸ The law is substantive under *Erie* because its purpose is to effectuate the state's Blue Sky laws which are designed "as a means of affording protection to the investing public from the nefarious practices of none too scrupulous brokers and dealers in securities."²⁵⁹

According to Speiser, federal courts have also applied state statutes providing recovery of attorney's fees in suits brought to compel release of a mineral lease. Although the federal circuit court, in *Stan-*

255. The current version of the statute is codified at TEX. CIV. PRAC. & REM. § 38.001 (Vernon 1986):

A person may recover reasonable attorney's fees from an individual or corporation, in addition to the amount of a valid claim and costs, if the claim is for:

- (1) rendered services;
- (2) performed labor;
- (3) furnished material;
- (4) freight or express overcharges;
- (5) lost or damaged freight or express;
- (6) killed or injured stock;
- (7) a sworn account; or
- (8) an oral or written contract.

256. 64 F.2d 64 (8th Cir. 1933) (cited in 2 S. SPEISER, *supra* note 140, § 14:4, at 12 n.43).

257. See IOWA CODE ANN. § 502.23 (West 1946), *repealed by* Acts 1975 (66 G.A.) ch. 235, § 621.

258. Comment, *Blue Sky Legislation*, 23 IOWA L. REV. 102, 114 (1937-1938) (noting that the purpose of statutes which void contracts made in violation of Blue Sky laws is to protect the purchaser).

259. *Id.* at 103.

olind Oil & Gas Co. v. Guertzgen,²⁶⁰ did not discuss the policy underlying the Montana Statute,²⁶¹ the Supreme Court of Montana has described the statute's predecessor as "remedial in its operation."²⁶² The Supreme Court of Montana further stated, "[I]t is merely a remedy afforded for the enforcement of private contracts."²⁶³ Consequently, the statute is substantive under *Erie*. Finally, Speiser noted that federal courts have applied state fee-shifting laws for libel suits. To illustrate, Speiser cited *Kellems v. California, CIO Council*.²⁶⁴ In that case, a federal district court followed a California statute²⁶⁵ mandating an award of \$100 to cover the attorney's fees of the successful party in a libel suit. A California court of appeals discussed the state policy underlying this statute in *Hills v. Shaffer*,²⁶⁶ and remarked that although such an allowance might appear to be a penalty, "the manifest object of the provision is to reimburse a defendant for the expenditure he has been put to in the employment of an attorney to defend the action."²⁶⁷ In *Hills*, the court noted that the provision on fees was accompanied by a provision requiring a written undertaking on the plaintiff's part in the sum of \$500 to help insure that the defendant could recover monies awarded from the plaintiff to cover costs, charges and attorney's fees incurred prior to dismissal of the action. In this setting, a court may interpret the statute as an attempt to cause a decrease in the number of libel claims and thus as an attempt to deter those seeking to chill the exercise of free speech rights.²⁶⁸ Viewed in this way, the statute is unconnected to any procedural law

260. 100 F.2d 299 (9th Cir. 1938) (cited in 2 S. SPEISER, *supra* note 140, § 14:4, at 12 n.44).

261. See *Stanolind*, 100 F.2d at 302 n.4 for discussion of the Montana statute.

262. *Solberg v. Sunburst Oil & Gas Co.*, 73 Mont. 94, 235 P. 761, 765 (1925).

263. *Solberg*, 235 P. at 765.

264. 6 F.R.D. 358 (N.D. Cal. 1946) (cited in 2 S. SPEISER, *supra* note 140, § 14:4, at 12 n.45).

265. CAL. CIV. PROC. CODE § 1037 (West 1980), *repealed by* Stats. 1986, c. 377, § 17, which provided:

If the plaintiff recovers judgment in an action for libel or slander, the plaintiff shall be allowed as costs one hundred dollars (\$100) to cover counsel fees in addition to the other costs. If the action is dismissed or the defendant recovers judgment, the defendant shall be allowed one hundred dollars (\$100) to cover counsel fees in addition to other costs, and judgment shall be entered accordingly.

266. 96 Cal. App. 520, 274 P. 388 (1929).

267. *Hills*, 274 P. at 389-90.

268. While the statute's directive that prevailing plaintiffs in libel or slander cases shall be allowed \$100 to cover counsel fees seemingly promoted the commencement of such cases, the bond requirement indicated legislative suspicions about the validity of many libel cases. Compare this with the security requirement for derivative actions in *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949). That statute was found to be substantive under *Erie*. See *supra* notes 69-101 and accompanying text.

goals, particularly as it requires the assessment of fees regardless of the reasonableness of conduct during litigation.²⁶⁹

Accordingly, the sources employed by Speiser in support of the statements quoted in footnote 31 are diversity cases in which federal courts applied substantive state laws on attorney's fees.²⁷⁰ Consequently, his work does not support the proposition that the *Alyeska* Supreme Court, in footnote 31, intended for federal courts hearing state law claims to apply all forms of state fee-shifting laws.

The foregoing analyses demonstrate that the decision in *Hanna v. Plumer*,²⁷¹ as well as the works of Moore and Speiser, compel an interpretation of the words "state law . . . which reflects a substantial policy of the state"²⁷² in footnote 31 to encompass only state substantive fee-shifting laws. These analyses, together with the recent

269. In *Kellems v. California*, CIO Council, 6 F.R.D. 358, 361 (N.D. Cal. 1946), the court, in an *Erie* setting, characterized the California law as substantive. The court's characterization is sustainable, but its conclusion that a federal procedural rule can limit the enforcement of a state substantive right seems wrong under the Rules Enabling Act, 28 U.S.C. § 2072 (1982), which requires that civil procedure rules not abridge, enlarge or modify any substantive rights.

270. Speiser did note one federal court's enforcement of a state fee-shifting statute allowing garnishees to recover counsel's fees. *New York Fin. Co. v. Potter*, 126 F. 432 (C.C. Pa. 1903) (cited in 2 S. SPEISER, *supra* note 140, § 14:4, at 12 n.40). In *Potter*, a federal court followed a now-obsolete Pennsylvania statute which provided:

Where, in any attachment execution, . . . the garnishee . . . shall be found to have . . . no real or personal property of the defendant, nor to owe him any debt, other than such property or debts as shall have been already admitted by the plea or answers of the garnishee, or in case, without going to trial, the plaintiff shall take judgment against the garnishee for what shall be so admitted in his plea or answer, then and in either such case, the garnishee shall be entitled, in addition to the costs already allowed by law, to a reasonable counsel fee out of the property in his or their hands . . .

Id. at 433. The court discerned the character of the provision when it stated:

The legislative intent, . . . was to concede to the plaintiff in an attachment the right either to accept what upon the answers it might be entitled to take, or to proceed for the purpose of establishing its right to something more, but subject, in the latter event, to the consequence that, if it should fail to establish its greater claim, the fund actually recoverable would be chargeable with the expense incurred by the garnishee in the employment of counsel to defend against the plaintiff's excessive demand.

Id. The Pennsylvania statute seemingly is comparable to Federal Rule 68 and thus may be procedural under the U.S. Supreme Court's analysis in *Marek v. Chesny*, 473 U.S. 1 (1985). See *supra* text accompanying note 30. Both the act and the rule provide incentives to accept offers made when there is a dispute, yet the act governs only attachment executions while the rule governs all civil actions. Use of the act by the federal court may, however, be sustainable because the case occurred long before *Erie* and the adoption of the Federal Rules of Civil Procedure, and thus involved a state statute which the court may have felt obliged to apply regardless of its character. See *Swift v. Tyson*, 41 U.S. (16 Pet.) 1 (1842) (local state legislative enactments binding on federal courts under Rules of Decision Act, now found at 28 U.S.C. § 1652 (1982)).

271. 380 U.S. 460 (1965). See *supra* notes 141-99.

272. *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 259 n.31 (1975).

Supreme Court decision in *Marek v. Chesny*,²⁷³ suggest that in an *Erie* setting, federal courts should apply state substantive fee-shifting laws and federal procedural fee-shifting laws, and that federal courts are not bound to apply state procedural fee-shifting laws.

CONCLUSION

Fee-shifting laws may be either substantive or procedural, whether in an *Erie* setting, a choice of law setting, or a separation of powers setting. In the *Erie* setting, one in which federal courts entertain state law claims while pretending they are state courts, federal courts have failed to appreciate the substance/procedure dichotomy in assessing state laws on the recovery of attorney's fees. The failure springs, in significant part, from a misunderstanding of Supreme Court precedents, particularly the dicta in footnote 31 in *Alyeska Pipeline Service Co. v. Wilderness Society*.²⁷⁴ As the continuing expansion of fee-shifting laws proceeds (with, perhaps, the exceptions swallowing the rule), it is time for courts to recognize the substantive and procedural characteristics of these laws and their significance when courts must make choices about laws and their lawmakers.

In making choices, the cases in the *Erie* setting suggest some guidelines. While these guidelines may be generally employed in all three settings, the results may occasionally vary from setting to setting.²⁷⁵ These guidelines indicate that a fee-shifting law related to the conduct giving rise to a cause of action is more typically substantive, while a fee-shifting law related to the conduct occurring during the course of litigation is more typically procedural. Further, they indicate that fee-shifting laws germane to acts commencing a cause of action or causing such a commencement may be either substantive or procedural, depending upon their purpose: a law which seeks to encourage or discourage the assertion of certain types of claims is usually substantive, while a law which seeks to deter the assertion of frivolous claims or defenses is normally procedural.

273. 473 U.S. 1 (1985).

274. 421 U.S. 240, 259 n.31 (1975).

275. See L. BRILMAYER, AN INTRODUCTION TO JURISDICTION IN THE AMERICAN FEDERAL SYSTEM 249-265 (1986). See also *City of Carter Lake v. Aetna Casualty & Sur. Co.*, 404 F.2d 1052 (8th Cir. 1979) (because statute on attorney's fees is characterized as substantive for *Erie* purposes does not mean it is similarly characterized for choice of state law purposes); *Stokes v. Reeves*, 245 F.2d 700, 702 (9th Cir. 1957) (same).